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ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 17th day of December, 1959

COMMISSION

Mr. M. A.	MacPherson, Q.C.	Acting Chairman
Mr. H.	Anscomb	Member
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COMMISSION COUNSEL

Mr. A. G. Cooper, Q.C.

Mr. G. S. Cumming

Mr. H. W. Ellicott - Adviser

Mr. F. W. Anderson	Secretary
Major N. Lafrance	Assistant Secretary

Commissioner R. Gobeil , absent.

REVISIONS OF WITNESSES

VOLUME 10

Page	Line	
2806	21	Change "constant" to "cost"
2818	19	Change "on" to "or"
	21	Change "qualified" to "qualifies"
2823	26	Change "first" to "certain"
	28	Change "terminal" to "practically"
2825	21	Insert "legislation" after "this"
	22	Insert "guaranteed" after "issue"
2828	12	Insert "the" after "or"
2837	4	Change "on" to "of"
	26	Insert "the earnings by" after "divide"
2846	9	Change "Poor" to "Poor's"
2857	29	Change "that" to "rates"
2858	22	Insert "do not" after "oil"
2859	8	Insert "railroad"after "big"
	9	Change "they" to "railroads"
	16	Change "make" to "take"
2860	4	Insert "Nautilus going under the" after "the"
	7	Change "with" to "for"
	8	Insert "now" after "traffic"
	last	Change "is" to "was"
2861	1st 4	Change to read: "inflation in the accounts of our railroads. The famous case of Smyth v. Ames involved Union Pacific Railroad. That company was involved in the Credit Mobilier scandal and millions of dollars of water was reported charged to its accounts."

Revisions (cont'd)

Page	Line	
2861	7	Strike "study of it, and" and substitute "finding of its cost of plant, and its"
2862	2	Change "and" to "about" and "of" to "with"
	6	Change "the" to "a"
2867	16	Change "is" to "are"

ERRATA

2816	10	Change "such" to "state"
2834	24	Change "community" to "common"
2858	4	Change "basis" to "base"
	5	Change "basis" to "base"

Ottawa, Ontario,
Thursday,
December 17, 1959.

---On commencing at 10.00 a.m.

THE ACTING CHAIRMAN: All right, Mr. Sinclair.

Mr. Sinclair, before we proceed, we had hoped this morning to release the dates of the western sittings, and they are being run off on the machine right now and we will have them for the press in time for the first adjournment.

MR. SINCLAIR: The next witness, sir, is Mr. Charles W. Smith, please.

MR. FRAWLEY: Rather than have Mr. Smith come from his chair at this time, I would like to make a statement which I have intimated I proposed to make and I think which should go on the record as my submission at this time.

Now, I object to the proposal of Canadian Pacific using a rate of return of 6½ per cent upon the property investment which they say is properly allocable to grain traffic, because, in my submission, this Commission, unless it wants to depart entirely on its own inquiry, in my respectful submission, should conform to the rule which has been laid down with respect to cost of money by the Board of Transport Commissioners; and I also would like to refer the Commission to no more than just the fact that the Turgeon Commission also refused to recommend that the rate base and rate of return technique be introduced to revenue cases by the Board of Transport Commissioners.

Then we have the rate base and rate of

return case where, as we know, the Board refused to recommend the adoption of rate base and rate of return as the sole criterion for the fixing of freight rates in Canada. There are several places where the Board dealt specifically with it, and I would do no more than to call the Commission's attention to one or two passages on page 63, and I am referring to the pamphlet copy of the Judgment of February the 15th, which is the Judgment of the Board, dated February 15th, 1954, and on page 63 the Board says:

"Both Mr. C. W. Smith and Mr. Nixon" --

Mr. Nixon is earlier described in evidence as a witness produced by the railways; he was, as I recall, an investment banker living in Montreal and associated with one of the well known investment houses there.

> "Both Mr. C. W. Smith and Mr. Nixon appeared to place great importance on the 'investor confidence' that they thought would result if the Board were to grant Canadian Pacific's request for the fixing of a 6½ per cent return on its railway investment."

I am not going to read it all, and I am telling my friend I am not reading it all, in case he wants to read it all, but in that same paragraph -- I am reading again --

> "As was agreed by Counsel for Canadian Pacific, the fixing of a rate of return is no guarantee that it will ever be earned."

Then I want to read this passage:

> "The evidence of Messrs. Smith and Nixon, portions of which I have quoted, leaves very

much in the realm of speculation and conjecture what effect on investors the granting of the request for the fixing of a 6½ per cent return would have. I also agree with Dr.Bonbright ---"

Dr. Bonbright was a Professor of Public Finance at Columbia University.

"--- I also agree with Dr. Bonbright that there is little precedent for the proposal in that respect and that its determination is not necessary to the determination of the request for a further 9 per cent general increase even if that request were not a conditional one."

Then on page 71, dealing with the summary of conclusions, conclusion numbered 3:

"The Board declines to accept the rate-base-rate-of-return method proposed by the Canadian Pacific Railway Company which, within the meaning of this application, would be the sole method of determining a permissive level of rates."

Then conclusion numbered 4:

"It follows that the Board declines to make a declaration that a return of not less than 6½ per cent is a fair return on the suggested rate base representing the net investment of the Canadian Pacific Railway Company in its rail enterprise."

I now proceed to the last 17 per cent Case, the Judgment of November 17th, 1958. There the

Commission will find on pages 12 and 13, a discussion of the method of determining what has come to be known as the permissive level of earnings, and the Commission will find there at page 31 of that same Judgment of the 17 per cent Case of 1958, Exhibit 58-30; that is the exhibit of the Canadian Pacific Railway. There the requirements are set out -- and it is Exhibit 58-31 (these exhibits are on the same page) -- there the requirements are set out as follows: Fixed charges -- $16,929,000; Dividends -- $20,661,000; an Allowance for Surplus -- $15,235,000; Allowance on Account of Transfer of Non-Rail Assets to Rail -- $2,400,000, which gives a total requirement of $55,225,000.

Now, if the Commission would go to Schedule 14 in Mr. C. W. Smith's memorandum ---

MR. SINCLAIR: It is not even filed.

MR. FRAWLEY: I am going to ask the Commision to bear with me, because my objection -- my friend says that I am not permitted to read Schedule 14, and I simply say that the most recent information is that there is a property investment of $1,440,149,678. That is the figure that is given to me by my adviser Mr. K. J. Morrison. If you take the figure of $1,440,000,000 and the requirements allowed by the Board in the 17 per cent Case of November 17th, 1958, and if you do the sum required, you will find that the rate of return disclosed by those figures is 3.83 per cent.

Now, in my view, that figure could not be exceeded in a proceeding of this kind where a portion

of the traffic is being costed, and to support that I want to call the Commission's attention to two matters. I first want to call the Commission's attention to the Judgment of the Board dated the 25th of January, 1952, and that is reported in 68 C.R.T.C., 273, and I would ask the Commission to go to page 21 of that Judgment where the Board is dealing with just what I have been dealing with here, the permissive level of earnings and what it is in terms of rate of return, and I read as follows, on page 21:

> "Based upon the evidence submitted in this and in previous cases, we have computed the amount which approximates, in our opinion, the net investment in railway property made by the C.P.R. as at December 31, 1951. After making due allowance for any items which may be contained therein that would be open to question upon a full and detailed examination of the consist of the items making up the total, the figure arrived at amounted to approximately $1,100,000,000. An earning requirement of $46,644,000"---

which I may interrupt to say was the permissive level of earnings.

MR. SINCLAIR: May I, please?

MR. FRAWLEY: I would like to read one more line.

MR. SINCLAIR: I think my friend and the Commission will recognize that the Board of Transport Commissioners, in the Judgment my friend

is referring to, were careful to point out, just before they made the comments that he is referring to, that they would not attempt to prejudge the amount that the Canadian Pacific Railway might regard as a fair return on invested capital. "This latter question was not argued in the present case and may be determined in a separate and later hearing . . ." I think my friend, in light of that ---

THE ACTING CHAIRMAN: Well, since you are up, Mr. Sinclair, I will ask you again what I asked you the other day, and that is the evidence that you propose to lead now is not addressed in any way to the method to be adopted by the Board of Transport in fixing just and reasonable rates?

MR. SINCLAIR: It is not addressed to you, sir, and the Commission.

THE ACTING CHAIRMAN: That is, that we should recommend that the method adopted by the Board should be different from what it is now?

MR. SINCLAIR: The method, no, sir. I am not asking the Commission to recommend to the Governor-General-in-Council that the permissive level of net rail income of Canadian Pacific be on a fixed rate basis.

THE ACTING CHAIRMAN: That is not the recommendation being asked for in the Turgeon Commission, for instance?

MR. SINCLAIR: No, sir.

MR. FRAWLEY: I was not making that the principal part of my argument at all, but I will

address myself to what my friend has said after I have read this.

Reading from page 21 of the Judgment of the Board on January 25th, 1952, it says:

"After making due allowance for any items which may be contained therein that would be open to question on a full and detailed examination of the consist of the items making up the total, the figure arrived at amounted to approximately $1,100,000,000. An earning requirement of $46,644,000 provides a return on the net investment, determined as previously explained, in the amount of approximately 4.25 per cent."

Now, to make that clear, I simply go back and state to the Commission that the figure of $46,644,000 is the amount of permissive level of earnings found by the Board.

MR. SINCLAIR: Would you read the next paragraph?

MR. FRAWLEY: Yes. Now, it says:

"Such a return is in the nature of the bare interest element of the present cost of money and approximates the return paid in today's market on high-grade bonds. It could be contended that the C.P.R.Co. stand possessed of certain advantages in the present market whereby the existence of other assets and the income, both present and potential, produced thereby, provide the necessary attraction

for the introduction of sums of new capital in a substantial measure further ameliorate the risks to be encoutered by such new capital."

(Page 2783 follows)

So, the Board there worked it out for themselves that the rate of return on permissible amounts of earnings and the amount for property investment would be expressed in figures of 4.25 per cent. Now, I next come to the next thing I want to bring to the attention of the Board.

COMMISSIONER ANSCOMB: That is 1950 what?

MR. FRAWLEY: January 25, 1952. Incidentally, apropos of that, you will see that the permissive level of earnings has risen to $55,225,000 and net investment has risen to $1,400,000. Now, I want to call to the Board's attention what is called "A Study of the Costs of Handling Coal from mines in Alberta and Eastern British Columbia to stations in Ontario" that was prepared by the Department of Research of the Canadian Pacific Railways. It is number Report S-37-52 and it is dated March 13, 1952. I want to read from the section of that report and I will attempt to have it received by the Board and filed as an exhibit.

MR. SINCLAIR: Mr. Chairman and members of the Commission, I think here we go back quite a few years and I am not quite sure of all the facts surrounding this. My friend and I were both a part of the settling of a dispute concerning rates on coal and certain work was done. I do not know how this document that my friend refers to became a public document and I am a little non-plussed to see it even has the stamp of this Royal Commission on it.

MR. FRAWLEY: That is simple, I gave a copy of it to the Secretary of the Commission.

MR. COOPER: Mr. Chairman, perhaps I should explain: This morning Mr. Frawley said he wanted to look at this document, that he had given the Secretary a photostatic copy and his own copy was in the office and he wanted to look at a copy if it were here. I happened to have it here and I passed it to Mr. Frawley so he could have a look at it but I did not understand it was to be introduced as an exhibit by Mr. Frawley this morning.

THE ACTING CHAIRMAN: It has not been considered by the Commission at all as yet.

MR. SINCLAIR: This is one of the difficulties that arises about dealing with people when they are in one capacity and sometimes in another. I do not know whether this was ever made public or not but I do recollect -- I do not want to transgress myself but I do recollect certain conferences between various people in regard to this question that we were dealing with. Now, specifically it deals with a matter that I have already spoken of in these proceedings which, in due course, I presume may become a matter of some interest to this Commission and it may not. It all depends on who Mr. Frawley brings as his witness, who he brings here and what questions we may put to him. I do not want to be mysterious about this in any way but any cost person that Mr. Frawley brings forth we will certainly have some questions to ask him about Alberta coal to Ontario points. Now, there are matters and movements that we feel quite strongly in being completely co-operative with our friends and in certain of these

matters we had produced figures and things of that nature and this may have been one we did not mind being made public but until it is I would certainly object to having it referred to.

MR. FRAWLEY: Perhaps I had better explain how it came into my possession because my friend said "I did not know it was a public document". Prior to 1952 coal had been moved from Alberta and south-eastern British Columbia to Ontario at what was regarded as a low rate, commonly called a low rate. My recollection is it was about $8.10 a ton at that time which had been filed in conjunction with the Federal Government subventions policy. About 1951 or 1952 the railways announced they were going to cancel the special rate -- I think that was perhaps the thing to call it -- and they were going to return the rate to the normal. "Normal" I think at that time published was about $13. The coal operators of Western Canada protested very strongly and I was acting at that time for the coal operators of Western Canada on the instructions of the Government of Alberta. We decided that there should be a costing made, a costing analysis made of the movement of the coal from the mines of Alberta and on the British Columbia side to points in Ontario. We retained Mr. Gilbert Parr in Washington for that purpose. Mr. Parr consulted with the cost section of the Canadian Pacific Railway and we made an application to the Board and that gave the matter status before the Board. Dr. Edwards came to

Ottawa for an informal conference and then later Mr. Parr was retained.

MR. SINCLAIR: Dr. Edwards was working for you.

MR. FRAWLEY: Yes, I did not mean to say by that that we preferred Mr. Parr to Dr. Edwards. It might have sounded that way but it is far from that. Dr. Edwards could not continue acting in the matter or something of that sort. Then after we made the application we said we wanted a cost analysis made.

THE ACTING CHAIRMAN: That is Dr. Edwards who was here yesterday?

MR. FRAWLEY: Yes, Dr. Ford K. Edwards and at that time he was chief research economist for the National Coal Association in Washington. We thought there should be a cost analysis. The Canadian Pacific, I think, at that time was already on their way to making one and Mr. Parr came in, actually came in a sort of supervisory capacity for the costing analysis which the Canadian Pacific cost section was undertaking. We had several conferences. The coal operators' representative and I were in Montreal on more than one occasion and Mr. Parr was there on many occasions. There never was any question of the thing being other than public to us.

MR. SINCLAIR: Well now, that is different -- "Public to us".

MR. FRAWLEY: Mr. Sinclair can make his

point later, I have not even disclosed the part of this document that I want to bring to the attention of the Commission so no harm has yet been done. I received a copy, I think not only one copy, but I received copies as the matter proceeded, as I recall. Mr. Whittaker, the executive manager of the Coal Operators Association also had copies. We had numerous conferences between Mr. Parr and ourselves and we received copies of all the letters that were written by Mr. Parr to the cost section and from the cost section to Mr. Parr. In the end this document emerged and this was the out-of-pocket cost -- those common words were used at that time -- out-of-pocket and all-inclusive and this is what emerged which has been in my possession quite legitimately, I hope, ever since the date of March 13, 1952. The proceedings before the Board were abandoned after this cost study was disclosed to the operators in Western Canada. Some other arrangements were made between the operators and the Government of Canada and the railways and the rates were restored partly, the rates were arrested in their upward movement but they did not go back to what was called "normal". The rates have stayed at this very considerably under $13 where they are now. I would not be too sure but in any event that was the situation when the matter was left in March 1952. At the request of the railroad, that having been the solution, the end result was that I withdrew the application which I had filed on behalf of the Coal Operators Association of Western Canada. So much for the proceedings.

As a matter of fact, this document, with the full knowledge of both the Canadian Pacific Railways and the Coal Operators, I was requested to furnish a copy of it to a gentleman by the name of G.A. Scott in the research department who was research economist in the Department of Transport at that time and who had been invited into the Board and at the Board's request I furnished Mr. Scott with a copy of it and I suppose that is now on file with the Department of Transport.

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That is where the matter stands, sir. If this is not a document which can be used -- because I was intending to use it, if I may say so without too much presumption,rather effectively in what I am addressing to the Commission -- there is not any point in discussing it. Certainly, I will discuss it if directed to by the Commission, of course, but ---

THE ACTING CHAIRMAN: I think the Commission would hesitate to receive that which would involve even a suggested breach of confidence.

MR. FRAWLEY: That is right, and I would be the last one to be a party to it.

THE ACTING CHAIRMAN: I do not think that is right. I think it is one of those matters in which, where working towards a settlement, documents might be exchanged which are more or less prejudicial, and it would be regarded, perhaps, as a breach of confidence. That being so, I do not think we should deal with it.

MR. SINCLAIR: Mr. Chairman, I will just underline one thing. My recollection of these matters is not as crystal clear as is Mr. Frawley's---

MR. FRAWLEY: If you do not mind my reminding you, it was Mr. Spence with whom I was dealing at that time.

MR. SINCLAIR: I have one memory of Mr. Frawley and Mr. Parr coming into the library at the Law Department of the Canadian Pacific where I attended, and I can ---

MR. FRAWLEY: Tell the whole story. Tell

all about Mr.Parr's walking in that day, Mr. Sinclair.

MR. SINCLAIR: I do not think I will do that because I can use that rather effectively, too, but what I think the Commission is interested in knowing is that because of this dispute about coal -- and, as I say, we may hear more about the rates on this traffic -- there was an understanding that the coal people and the railways would work together in developing certain things. Now, I think that is clear from what Mr. Frawley said.

MR. FRAWLEY: That is so.

MR SINCLAIR: Now, when you work together with Mr. Frawley to come to an agreement it is necessary for you to give sometimes quite a lot in certain places. That has been recognized by many. Whether that occurred on this occasion or not, I do not know, but I do know that in numerous conferences which were attended by Mr. Frawley and his expert cost material was developed, and I think it was used by Mr. Frawley's clients and the National Coal Board. Whether any part of it is Mr. Parr's, and another part is Mr. Barnstead's, and another part somebody else's, I do not know, but it would be my position that just because a document was put in final form by the Research Department then any part of it taken out can no more be ascribed to Canadian Pacific than it can be ascribed to Mr. Frawley.

MR. FRAWLEY: The Canadian Pacific was very proud of the work, because it ran up the cost

to a point -- I will be very frank about it -- it ran up the cost to a point where we just threw up our hands and said: "That is a lot more than we expected it would be."

THE ACTING CHAIRMAN: I know that Mr. Frawley would not want to use in argument anything that is improper.

MR. FRAWLEY: I should say not.

THE ACTING CHAIRMAN: I think if we adjourn for five minutes Mr. Frawley and Mr. Sinclair might look at this again and see if it is what we are now understanding it to be, namely, something that was in the nature of a memorandum used in a proposed statement which would be probably of prejudice, and was not intended to be used at a later date.

MR. SINCLAIR: Apparently my friend has already filed it with the Commission.

MR. FRAWLEY: I have not filed it.

MR. COOPER: It is not actually filed with the Commission.

THE ACTING CHAIRMAN: No, it is not filed, and we do not want it filed unless it can be properly filed.

MR. FRAWLEY: It is not filed, in any sense of the word.

THE ACTING CHAIRMAN: Well, we will adjourn for five minutes.

---Short recess.

MR. FRAWLEY: Quite apart from Mr.

Sinclair's objections, Mr. Chairman, I have had further discussions about this, and I do not propose to offer it as an exhibit. I could not seriously do that. It is not proved simply by my handing it over the railing to the Secretary, so it cannot be offered as an exhibit. The other thing to do would be to read from it, and it would not be proper for me to read from it unless it is before the Commission, or in such a fashion that it can be put before the Commission. Having regard to that I terminate any reference to the matter.

Now, by simply pointing out that in the Judgment of January 25th, 1952, which is known as the Judgment in the 17 per cent case and which is reported in 68 C.R.T.C., 273, the rate of return which resulted from applying the permissive level of earnings to the established net rail investment was 4.25 per cent. It is rather meaningless to make that statement, but I am certainly not going to pursue the coal cost study of 1952 any further.

Now, I want to deal for a moment with the importance of this matter in view of the question you addressed to Mr. Sinclair: Is Mr. Sinclair endeavouring to change the established method of fixing freight rates in Canada, and to put it on a rate base and rate of return method ---

THE ACTING CHAIRMAN: That is the question I asked.

MR. FRAWLEY: That is right, and Mr. Sinclair said that he was not, but Mr. Sinclair is

arguing to this Board ---

THE ACTING CHAIRMAN: He is not arguing to the Board..

MR. FRAWLEY: I am sorry; Mr. Sinclair has argued to the Commission, and the precis of evidence that he has put in and which have already been put into the record make the proposition, that the rate which he is seeking is a just and reasonable rate; when the rate is put from .5 or ½ cent per ton mile to 1 cent per ton mile, namely, its full cost, that will then become a fair and reasonable, or a just and reasonable -- to use the language of the Railway Act -- that will become a just and reasonable rate. How will it become a just and reasonable rate by using 6½ per cent as a rate of return as the cost of money on the rate base which he proposes to prove through Mr. Smith or other witnesses?

In my submission, at the moment rates in Canada are just and reasonable when they return 3.83 per cent. That is what the rates today are returning to the Canadian Pacific Railway. We know that the Canadian Pacific have argued in season and out of season -- and, perhaps, the Canadian National -- that that is a ridiculously low rate for the railways of Canada to be earning. They have said that many times, and they probably feel that, but at the moment that is the rate that emerges from the disposition made in the Revenue Case by the Board of Transport Commissioners -- 3.83 per cent.

As I have indicated this morning, rates

in Canada are just and reasonable because they return 3.83 per cent, but we are going to have grain return 6½ per cent. In so far as grain is concerned if the Commission is to allow a 6½ per cent return on the investment used in carrying the grain then the result of the Commission's deliberations, the Canadian Pacific submits, will be a just and reasonable rate. I say it is completely incongruous -- completely incongruous. You are going to have livestock moving in Canada at a rate level which returns to Canadian Pacific Railway 3.83 per cent.

My friend may say: "No. The 3.83 per cent is just the result from putting the permissive level of all earnings into all of the total investment, and you might have some one per cents, some two per cents, and some seven and eight per cents." I say: "No." I say: "The 3.83 per cent is what the Board of Transport Commissioners have determined is the proper cost of money for the Canadian Pacific Railway Company."

If it actually costs the Canadian Pacific more -- if they actually spend more for their money the Board nevertheless says: "As against the freight shipper of Canada we will only ask him to pay 3.83 per cent."

I do not know whether I am putting it well or not, but that is the essence of the situation as I see it, and in my respectful submission it would be -- I do not say "ridiculous", but in my submission it would be completely indefensible to move

the apples, coal, livestock and farm machinery using a rate of return not exceeding 3.83 per cent and to say: "Oh, well, when we are costing the grain we are going to ask Mr. Smith to subject this matter to his very careful and competent examination, and then will emerge the figure of 6½ per cent, and we say that if if 6½ per cent is used then you have a fair and reasonable rate for grain."

So, you have a fair and reasonable rate for grain at 6½ per cent, and you have a fair and reasonable rate for livestock and for farm machinery at 3.83 per cent.

That is my submission, sir, and I think it is well to make it now before Mr. Smith gives his evidence.

THE ACTING CHAIRMAN: Mr. Frawley, you have very forcibly made your submission, and the Commission has discussed the whole of this before, and also during the recess again, and we feel that we should not interfere in any way with the functions of the Board of Transport Commissioners. We are, by the Terms of Reference, specifically denied that right, but we feel that Mr. Sinclair has the right to make his case, good or bad, and consequently we would ask him to lead his evidence.

MR. FRAWLEY: Let me just say one more word. I think I made it clear when I first spoke that this Commission in its recommendations can say that 6½ per cent -- I would not want the Commission to misunderstand me at all -- the Commission can say that 6½ per cent is too small. The Commission can

say the proper rate is 8 per cent. All I say to the Commission is that if you are doing that you are completely departing from the rule laid down by the Board of Transport Commissioners.

THE ACTING CHAIRMAN: You have made your point very clearly, Mr. Frawley, and it will all be kept in mind.

MR. SINCLAIR: There is one point I might mention so that the Commission may not be misled, and I am sure Mr. Frawley would not want them misled. I rather anticipated what might be done here, so last night I had sent to me the documents with respect to the drafting of the application that was dealt with by the Board in the 17 per cent Judgment which Mr. Frawley referred to and which is dated November 17th ---

THE ACTING CHAIRMAN: The last 17 per cent Case?

MR. SINCLAIR: Yes, that is right. He said this 3.83 per cent was a determination of what would be a just and reasonable level of net rail income for the Canadian Pacific, and as I suspected, because I did have a little to do with this drafting, I find in the application these words:

> "Applicant believes the basis of the permissive level of earnings above referred to does not reflect a proper level of earning power for Canadian Pacific and the fixing of just and reasonable freight rates for the railways of Canada. Such a basis is accepted for the purpose of this application alone,

and under reserve of all rights."

THE ACTING CHAIRMAN: I think the figure Mr. Frawley gives is a figure which has been deduced from the arithmetic of the matter.

MR. FRAWLEY: That is right. With the Commission's indulgence may I ---

MR. SINCLAIR: I have one more point.

MR. FRAWLEY: I am sorry.

MR. SINCLAIR: Indeed, in the 17 per cent Judgment that Mr. Frawley referred to at page 19 the Board said:

> "The level of Canadian Pacific's financial requirements will be reviewed by the Board when considering the part of the application requesting final relief . . ."

It is clearly wrong, on the application and the finding of the Board to which I have just referred, to say that rates in Canada are just and reasonable when they return 3.83 per cent. The point I wish to make, Mr. Chairman, of course, is this, that my friend, when he says that the rates for the cost of money for the movement of livestock is 3.83 per cent, is wrong. When he says for farm machinery it is 3.83 per cent, that is wrong. All he has done is to make a methematical calculation, and nothing else.

(Page 2801 follows)

THE ACTING CHAIRMAN: Well, Mr. Sinclair, the experience of the Commission so far is that everything Mr. Frawley says is wrong and everything you say is wrong, as between the two of you. However, I think now that we have ruled, you may proceed.

MR. SINCLAIR: Thank you, sir.

MR. FRAWLEY: I appreciate the Commission's ruling and I only want to put this in the record so that it will be in its proper place. I refer the Board to the judgment of the Board of Transport Commissioners in the Increased Commutation Fares case, Board file 29984.18, which is a judgment of the Board dated the 6th of November, 1959, and I direct the Commission's attention to pages 26 and 27.

THE ACTING CHAIRMAN: The press may obtain copies from the Secretary. All right, Mr. Sinclair.

MR. SINCLAIR: I will call Mr. Smith now.

SMITH, Charles W., Called:

DIRECT EXAMINATION BY MR. SINCLAIR:

Q. This witness is Charles W. Smith. Mr. Smith, you are a public utility consultant and you reside in Baltimore, Maryland?

A. That is right.

Q. You hold a Bachelor of Science degree in Finance and Business Administration, and you also have a degree in law?

A. Yes.

Q. You are a certified public accountant of Maryland and of North Carolina, and a member of the Maryland bar and the United States Supreme Court bar?

A. Yes sir.

Q. You are a member of the Maryland C.P.A. Association, and you have been its president a number of years ago, and you are a member of the Maryland Bar Association, the American Institute of C.P.A.'s, the American Bar Association Administrative Law Committee and the American Economic Association?

A. That is right.

MR. SINCLAIR: I think, Mr. Chairman, that I might just read the qualifications of Mr. Smith.

THE ACTING CHAIRMAN: Yes.

MR. SINCLAIR: Mr. Smith was an auditor in the Bureau of Internal Revenue, United States Government, from 1920 to 1929. He was chief auditor of the Public Service Commission of Maryland from

1929 to 1936, and a Bureau Chief of the Federal Power Commission, most of the time with the title of Chief of the Bureau of Accounts, Finance and Rates, from July 1936 until September 1955.

Mr. Smith taught accounting in evening classes at Johns Hopkins University for a number of years. He entered private practice on his own account in October of 1955.

Over the years he has been a member of many professional committees; one of these was a committee financed by the Rockefeller Institute and the American Society of Certified Public Accountants for the study of business income. The committee made a report which was published by MacMillan in 1952. He was a member of a joint committee of the American Bar Association, American Society of Civil Engineers and others which made a rather exhaustive report on water and sewage systems. That report was published by the Ohio State Law Journal in 1951. For approximately 20 years he was a member of two committees of the National Association of Railroad and Utilities Commissioners, namely, the Committee on Accounts and Statistics and the Committee on Depreciation. Mr. Smith helped draft the comprehensive report on Depreciation of the Railroad and Public Utility Commissioners Association, which was made in 1943.

In 1935 and 1936 he was retained by the Federal Power Commission to supervise the drafting of the system of accounts for electric utilities which the Commission adopted in 1936.

After he became a full time staff member of the Federal Power Commission he was engaged in the regulation of Public Utility accounts, approval of security issues and other financial matters, the regulation of rates, the issuance of certificates of public convenience and necessity to natural gas companies and the compilation of financial and operating statistics. At the peak of his work for the Federal Power Commission he supervised a staff of 300 accountants, engineers and financial specialists, together with numerous associated clerks and stenographers.

Now, Mr. Smith has testified in more than 75 public utility proceedings, including cases before the Federal Power Commission, the Federal Communications Commission and the Securities and Exchange Commission, and also before numerous public service commissions throughout the United States. In all but three of these cases he testified on behalf of a regulatory commission. Eight of the cases in which he testified were passed upon by the Supreme Court of the United States, and one of these, Hope Natural Gas, which is reported in 320 U.S. 591, and this case is considered as one of the leading public utility rate cases both in the United States and in Canada.

Now, he has testified on fair rate of return before the Public Service Commission of Maryland and the Federal Power Commission, and also before other state commissions while he was in the employ of the Federal Power Commission, under statutory

arrangements between the State and the Federal Power Commission. Indeed, in 1952 he obtained a leave of absence from the Federal Power Commission and testified on behalf of Canadian Pacific in a case before the Board of Transport Commissioners.

Mr. Smith has been a consultant on financial matters, municipally-owned utilities and to privately owned utilities, to large and small and medium gas companies and electrical companies and other public utilities.

Q. Does what I have said to the Commission correctly sketch out your career, Mr. Smith?

A. That is right, except that it is larger than I would have put it.

Q. It is a little larger than Mr. Smith would have put it.

Mr. Chairman and members of the Commission, Mr. Smith prepared a memorandum regarding the cost of capital, which has been filed with the Commission for their information and it was made available to my friends some time ago.

The memorandum which contained a precis of the evidence which I will introduce to the Commission through Mr. Smith, was for the purpose of supporting the rate used in developing the cost of money included in the cost of transporting grain and grain products moving at statutory and related rates to export positions in Western Canada.

The Board will remember that reference to this rate, namely, 6-1/2 per cent, was made in the

evidence of Mr. Stenason and was also referred to in the evidence of Dr. Edwards, which is already before the Commission.

During the evidence of Dr. Edwards yesterday he said, and I am quoting, "The cost of servicing the investment in plant and equipment is no less real than any other cost."

MR. SINCLAIR: Q. Do you or do you not agree with that statement, Mr. Smith?

A. I agree fully with that statement.

Q. How do you relate cost of capital to the determination of cost of a service, such as moving grain?

A. In determining costs of producing a product or service full recognition must be given to the cost of capital or what is sometimes termed "cost of money". Such a cost is expressed as a percentage rate on investment and measures the compensation required for the use of the capital.

Q. Now, do regulatory commissions, with which you are familiar, make use of constant capital studies in determining not only permissive levels of the rates overall, but also make use of them in determining specific rates.

A. Public utility regulatory commissions in general make extensive use of what are known as "cost of capital" studies. These studies are usually divided into three main parts, debt capital, preferred stock capital and common or ordinary stock equity capital, with a summary schedule showing

the cost to the particular company under review.

Q. How is cost of debt and preference stock capital developed, Mr. Smith?

A. It is developed by studying the cost over a period, but in the present case I have used the cost of debt and preference stock capital as the current cost of 1958.

Q. How was the cost of common equity capital developed?

A. The cost of common or ordinary stock equity capital is what is required to protect the financial integrity of the enterprise and thus permit it to attract such capital on reasonable terms and conditions.

Q. You mentioned earlier cost of capital studies, and said that they were used in determining specific rate levels in regulatory commissions, and have you prepared such a cost of capital study for Canadian Pacific?

A. Yes, there has been prepared by me or under my supervision and direction a cost of capital study for Canadian Pacific which is identified as Statement 600.

MR. SINCLAIR: With your permission, Mr. Chairman and members of the Commission, the way I would like to handle this with the witness is to file as one document and as one exhibit this entire study, and it is so set up that it is easily handled in that way because I will refer to it by charts and schedules which are numbered in it, and

I think you can follow it very easily from the record if this goes in as one exhibit.

MR. COOPER: That will be satisfactory, Mr. Chairman. The exhibit number will be 75.

---EXHIBIT NO. 75: Cost of capital study for Canadian Pacific Railway.

MR. SINCLAIR: Q. In Exhibit 75 what have you included?

A. I have included in the study samples of the cost of money to the Governments of Canada and the United States, as well as other railroads and utilities to show the costs to a broad cross-section of the users of capital.

Q. In determining and carrying on your cost studies, Mr. Smith, and in doing this one, what is your purpose?

A. The purpose is to find the cost of capital; that is, to my mind the cost of capital is just as much a cost as the cost of labour, and the purpose is to find reasonable costs of capital.

In some cases we can get down to the specific costs, such as the cost of bonds and preference stock, but in other cases we must find what is reasonably required in order to attract capital and preserve the financial integrity of the company. The latter refers, of course, to common stock.

Q. Now, you have said earlier that you included in your cost of capital study, which is now Exhibit 75, the cost of money to the Governments

of Canada and the United States. Now, I would like to discuss the interest cost of Governments with you for the assistance of the Commission, and would you look at Exhibit 75 and do that now, please?

A. Yes.

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Q. Well, now, the cost of money to the United States Government is on Chart 1. Would you just say what that shows?

A. Chart 1 of the study shows the yields on United States Treasury Bonds, long term issues, from 1920 to August, 1959. The yields are for outstanding bonds traded on the markets and not the yields on original offering price.

There are three lines on the chart, representing three series of yields. The first represents issues on which the interest was partially tax exempt and this series ran from 1920 to 1945. It will be noted that there was a general decline in the yields on this series throughout the entire period. The bonds included in this first series were due or callable in eight years.

The next series covers the period 1943 to 1957. The interest on the bonds included in this series was taxable, that is to say, the interest was subject to income tax, and the bonds included therein were due or callable in general in 15 years. It will be noted that from 1943 to 1946 there was somewhat of a decline in yields and thereafter yields increased rather steadily except for a dip in 1954, after which the upward climb continued. Schedule 1 following the chart shows the yields increased from 2.47 per cent in 1943 to 3.47 per cent in 1957.

The last series began as of 1954 and has continued down to date. This series is based upon bonds maturing or callable in 10 years or more.

The interest is taxable. In general the yields increased to the latter part of 1957, then a dip occurred, reaching the low point in April, 1958, after which there was a steady increase in yields, the yield for August, 1959 being 4.10 per cent.

Q. Yes. Now, in measuring risk, how are Treasury Bonds regarded in the United States?

A. In the United States it is considered that the interest on Treasury Bonds is the best indicator that can be obtained of what is sometimes called the "pure cost of money". In other words, the yields represent the real cost of money divorced, as nearly as anything can be, from risk.

Q. On that, in view of a question that was put by Commissioner Anscomb this morning, would you just pick off 1952 and the yield on United States Treasury Bonds, the pure cost of money in 1952?

A. In 1952 the average was 2.68 per cent.

Q. And the present?

A. The last date, as of August, 1959, 4.1 per cent.

Q. Now, does Chart 1 and Schedule 1 you have just referred to, that is the schedule following the chart, indicate the change in the cost of money over the entire post-war period in the pure cost of money in the United States?

A. It shows generally from 1920 down to date.

Q. What has happened to the cost of

money from 1946?

A. The Chart and Schedule 1 following the Chart show what is common knowledge, namely, that the cost of money has risen greatly since the low point in 1946 and very perceptibly since April, 1958. Thus the increase in average yield from 1946 to August, 1959, was 87 per cent; the increase from April, 1958, to August, 1959, was 31 per cent.

Q. Has this caused concern in the United States?

A. Yes. The increase in cost of money to the United States Government has been so drastic that the Treasury Department has felt compelled to request Congress to increase the ceiling on interest rates of long term Government bonds, that is, bonds maturing in more than five years. The ceiling is 4-1/4 per cent. That ceiling was imposed a long time ago in the Second Liberty Loan Act of 1918. The Congress has not honoured the request of the Treasury Department and as a consequence, the Treasury in August 1959 issued $2 billion of notes due in 1964 at a cost of 5 per cent.

Q. Now, do I take it that what you are saying there is that even the United States Government has had to take action, in light of the present situation, to resort to matters that would go around restrictions, what they could pay for money?

A. Yes. They issued notes maturing in four years and 10 months at an interest rate considerably higher than the ceiling which was imposed on

the bonds maturing in more than five years.

Q. Now, would you look at Schedule 2 of Exhibit 75, please?

A. Schedule 2 is a tabulation showing the yields on U.S. Treasury and Government of Canada bonds. Yields on the U.S. Treasury bonds are taken from Schedule 1 which I have previously discussed and the yields on the Government of Canada bonds are taken from a compilation, which I understand has been discontinued, of the Bank of Canada. The yields I have used from the Bank of Canada study relate to 15-year bonds. It will be noted that the yields on the Government of Canada bonds have generally paralleled the U.S. Treasury's except that on an average, the Canadian bonds have yielded about 1/2 per cent more than the Treasury's. According to the Federal Reserve Bulletin for July 1959 (page 689) during the last half of 1958 the yields on long-term Canadian Government bonds increased about 1/2 per cent, about the same as the U.S. Treasury bonds.

Q. On Schedule 2 of Exhibit 75 you show each of the years 1946 through 1958 and then by month of 1959, January through June; is that correct?

A. Yes, sir.

Q. Now, you have a further comment to make concerning comparison between Canadian Government and United States Treasury bonds?

A. I might note that as of June 30, 1959 Government of Canada 3-1/4 per cent, 1979 were selling to yield 4.92 per cent whereas U.S. Treasury, 3-1/4

per cent 1978-83 were selling to yield 4.09 per cent. The yield on the Government of Canada 3-1/4 per cent increased from 4.41 per cent on January 7, 1959 and the U.S. Treasury's from 3.84 per cent.

Q. Now, Mr. Smith, what is your overall conclusion concerning costs of money from the yields on Government securities that you have just been discussing?

A. It is readily apparent that the cost of money as nearly as we can divorce such cost from risk has risen very substantially in recent years, both in United States and in Canada.

Q. Before we go to the next subject, do you, in your broad experience and practice and your studies, know of any utility, railroad or business of that nature, that can secure money equal to Government rates?

A. I know of none that can do it on today's market. My only reservation is the phenomenal low cost of interest of the Canadian Pacific Railroad relating to debt issued in the past. Currently, the Government money is the cheapest money.

Q. And your only reservation is some of the money that is in Canadian Pacific?

A. Due to unusual circumstances, Canadian Pacific has some phenomenally low cost capital.

MR. SINCLAIR: We will talk about that later for the benefit of the Commission, for the assistance of the Commission.

THE ACTING CHAIRMAN: We will recess for five minutes.

---Recess.

THE ACTING CHAIRMAN: I think, Mr. Sinclair, before we go on, I will have the reporter take into the transcript our directions as to the Western hearings.

Western Hearings

City	Sitting
Winnipeg	Mon. Feb. 8/1960
	Tue. " 9/1960
	Wed. " 10/1960
Regina	Fri. " 12/1960
	Sat. " 13/1960
	Mon. " 15/1960
Edmonton	Tue. " 16/1960
	Wed. " 17/1960
	Thu. " 18/1960
Victoria	Fri. " 19/1960
	Sat. " 20/1960
Vancouver	Mon. " 22/1960
	Tue. " 23/1960

MR. SINCLAIR: Thank you, sir.

Just before the break, sir, I had one other question I wanted to ask Mr. Smith concerning cost of capital, and you remember his answer in that regard, and I now would like to expand that one step further and ask him whether, in the United States, there is any practice continuing, such as was depicted in the Chart 1, of tax exempt securities.

Q. Are there any of those still extant in the United States?

A. Yes. Municipalities can issue debt securities which are exempt from federal income tax, and some of these municipalities, by reason of this

tax exemption, are able to issue debt securities at a lower cost than is indicated by the cost to the Government of the United States for long-term debt.

Q. Your answer there is that that is restricted to certain arrangements with municipalities and the Federal Government.

A. It is a matter of constitutional law that the Federal Government is not supposed to tax directly the state governments, and so such governments do not tax the income from federal securities and the Federal Government does not tax income from state securities.

MR. SINCLAIR: Now, Mr. Chairman, I wish to discuss with the witness, with your permission, the cost of debt capital so that we may have it before us. Would the Commission and my friends turn to Chart 2 of Exhibit 75.

Q. With Chart 2 of Exhibit 75 before you, Mr. Smith, would you please comment on this?

A. Chart 2 shows yields on bonds according to industries, that is to say, industrials, public utilities, and railroads. The yields, which are compiled and published by Moody's Investors Service, have wide acceptance in banking and financial circles. Schedule 3, sheet 1, shows the details underlying the chart.

Q. What is the significant point you wish to draw to the attention of the Commission from this chart?

A. It will be seen from the Chart and the supporting Schedule 3 that yields on the bonds of the three groups moved together but with the yields on railroad bonds being higher than the yields on the other two groups during most of the period since the depression of the 1930's. Thus in 1957 the average yield on railroad bonds was 4.32 per cent, on industrials 4.12 per cent, and utilities 4.18 per cent. As of November 13, 1959 the yield on railroads was 4.99 per cent, on industrials 4.70 per cent, and on utilities 4.88 per cent. I should point out that the yields are computed on transactions in outstanding bonds and are not yields based upon issue price.

Q. What does Sheet 2 of Schedule 3 show, Mr. Smith?

A. Sheet 2 of Schedule 3 shows the yields on railroad bonds by ratings. The compilation is by Moody's as are the ratings. The ratings from highest to lowest grade are Aaa, Aa, A, and Baa. The yields generally moved together except the yields were lower on the better grade bonds. Thus the average yields for Aaa, Aa, A, and Baa bonds respectively for the year 1957 were 3.94 per cent, 4.17 per cent, 4.29 per cent, and 4.89 per cent.

Q. That is shown at line 8 of Sheet 2 of Schedule 3 of Exhibit 75?

A. Yes.

Q. For 1958, taking it also from that schedule?

A. For 1958 they were 3.88 per cent, 4.12 per cent, 4.40 per cent, and 5.16 per cent.

Q. That is at line 22 of Sheet 2 of Schedule 3 of Exhibit 75?

A. That is correct.

Q. And at line 31, November 13, Schedule 3, Sheet 2, Exhibit 75?

A. As of November 13, 1959, they were 4.61 per cent, 4.88 per cent, 4.97 per cent and 5.49 per cent.

Q. You have shown Aaa, Aa, A, and Baa. What is the rate that Moody's give to Canadian Pacific debt security?

A. The collateral trust bonds of Canadian Pacific are rated Ba by Moody's.

MR. FRAWLEY: You were at a lower rating than Baa?

THE WITNESS: Yes, that is correct. The Ba ratings on yields are not usually shown because the Baa, generally speaking, is the lowest rating which qualified for investment by banks.

(Page 2822 follows)

MR. SINCLAIR: Q. And a lower rating than Baa, would the yield be lower or higher?

A. The yield would be higher; as the grade of bond goes down the rate of yield goes up.

Q. Now, sheet 3 of schedule 3 of Exhibit 75, would you just mention what that is, Mr. Smith, please?

A. Sheet 3 of Schedule 3 shows how Moody's bond yields are compiled and contains a general explanation of the ratings. The companies included in the bond yield study, classified by the three industry groups and by ratings, are shown on sheets 4 and 5 of Schedule 3.

Q. Schedule 4 of Exhibit 75 shows the yields on new issues of utility and railroad bonds. May we have your comments on that, please?

A. Schedule 4 shows the yields on new issues of utility and railroad bonds. The yields are based upon original offering price. In general the trend of yields follows the trend on the seasoned bonds except that the yields on the newly issued bonds were generally higher than on the seasoned bonds. Thus by comparing utility bonds, we find that the seasoned bonds in 1955 had a yield of 3.22 per cent, the newly issued bonds 3.33 per cent; in 1956 the seasoned bonds 3.54 per cent and newly issued 3.86 per cent; in 1957 seasoned bonds 4.18 per cent and newly issued 4.74 per cent; and in 1958, seasoned 4.10 per cent and newly issued 4.21 per cent. A similar comparison for the railroad bonds giving first the seasoned bonds and

secondly the newly issued is as follows:

1955 - 3.34% as compared with 4.12%

1956 - 3.65% as compared with 5.25%

1957 - 4.32% as compared with 5.01%

1958 - 4.39% as compared with 4.56%

I know as a matter of fact from constant study of bond issues that new issues of the same grade have been selling in recent years at higher yields than the yields on seasoned bonds of the same company.

Q. In recent times, Mr. Smith, have railroads been financing largely by bond issues?

A There has been very little bond and debenture financing by railroads in recent years. Most of the debt financing of railroads has been through equipment obligations.

Q. Have you any examples of bond debenture railroad issues in recent years?

A. Yes, there was one public issue of railroad bonds in 1956, namely, Southern Pacific 5½'s due 1983 in the amount of $35 million. These bonds which are rated Baa, were offered on September 20, 1956, at par, resulting in a yield of 5½ per cent.

Q. Now, you call that what, a line haul railroad?

A. Line haul to distinguish it from terminal railroads. First terminals such as Union Station in Washington have issued some bonds but they are terminal guaranteed bonds and I have ignored those.

Q. Any debenture issues?

A. There was likewise one issue of debentures in 1957, namely, Western Maryland Railway Company 5½'s due 1982. These debentures were exchanged for preferred stock of the company which was held by the B & O Railroad and the offering was by the B & O. The debentures which are rated Baa were sold on January 17, 1957, at par yielding 5½ per cent.

Q. Now, what railway issues were made in 1958?

A. There were five issues in 1958 as follows:

Chicago, Burlington and Quincy 4-3/8% bonds due 1978 $24,500,000. The bonds were offered in January to yield approximately 4-3/8%.

Virginia and Southeastern Railway Company 4½'s $5,000,000, rated A, offered March 7, 1958 to yield 4½%.

Chicago, Rock Island and Pacific 5½% bonds $16,000,000, rated Baa, offered March 13, 1958 to yield 5½%.

Virginian Railway Company 4% bonds, $12,000,000, rated Aa, offered May 2, 1958 to yield 4%.

Southern Railway, 4½%, $22,000,000, rated A, offered July 16, 1958 to yield 4½%.

Q. What about 1959 railroad issues, bonds or debentures?

A. As far as I can learn there were no

bonds or debentures issued publicly by railroads during the first ten months of 1959.

COMMISSIONER MANN: May I ask a question of the witness?

MR. SINCLAIR: Yes, certainly.

COMMISSIONER MANN: The Smathers Committee last year, I believe, made a report as a result of which there were some arrangements made for guarantee of loans by the Government to the United States railroads?

THE WITNESS: Yes.

COMMISSIONER MANN: Has that had any influence on whether or not bonds were issued by the United States railroads this year?

THE WITNESS: That has not had any real effect as yet. You refer to the Transportation Act of 1958 which was an Act passed to relieve railroads in the United States. There were many proposals to Congress, one of them was to give railroads a complete hand in fixing rates but railroads are recognized as being in a distressed condition and Congress enacted this to allow railroads to abandon lines almost on their own initiative and permitting them to issue debt upon approval by the ICC. The ICC have some restrictions in connection with that debt which the railroads did not like, and so far I do not believe there has been one loan under that Act.

COMMISSIONER MANN: I wonder whether you would check on that. I am almost certain in my own mind that several railroad companies have made use of this and I think Maine Central was one.

THE WITNESS: That was one which was proposing to use it and several railroads did have discussions, but I attended a meeting in my Washington office when I was first asked to make this study and at that time a C.P man was there and he said he had checked on it and he said none had actually been exercised as yet. That was my inquiry then, but I will try to find out again.

COMMISSIONER MANN: If you would be good enough to do that and advise us.

MR. SINCLAIR: The applications you have in mind are small New England roads? New Haven?

COMMISSIONER MANN: I do not know. You see, my disadvantage is I am away from my material and I have a recollection of several such applications being made and being used.

MR. SINCLAIR: And then finalized and granted?

COMMISSIONER MANN: Not as far as I know, but perhaps Mr. Smith could check on that.

MR. SINCLAIR: Yes, and we can inform the Commission when Mr. Smith comes back on January 11th.

COMMISSIONER MANN: Thank you very much.

MR. COOPER: Perhaps at this point Mr. Sinclair might ask the witness whether there was any particular reason why 1956 does not appear on Charts 1 and 2.

MR. SINCLAIR: Q. In looking at Charts 1 and 2 of Exhibit 75, would you please say where 1956 is on those charts, where the year 1956 is?

A Well, the year 1956 is not shown on that particular chart. One of the problems -- we have to be frank with you -- is to condense the space. This chart was one I started back about 1929 and is taken directly from the Federal Power Commission chart that is now used. We constantly try to cut out something either on the end or the middle. I have in mind we are probably going to cut out more in the middle to save space. That is primarily the reason, it is chartmakers' technique

THE ACTING CHAIRMAN: There is nothing significant about it?

THE WITNESS: Nothing significant about 1956.

MR. SINCLAIR: Q. Now, what about Canadian Pacific issues in recent years?

A. Canadian Pacific had one issue of long-term debt securities, other than equipments, after 1955. That was an issue of $40,000,000 5 per cent collateral trust bonds dated February 1, 1958, sold at a yield of 5.14 per cent. The bonds are rated Ba by Moody's.

Q. Now, what have railways resorted to in recent years for financing and the type of issues?

A. The chief debt financing of railroads in recent years has been accomplished through the issuance of equipment trust certificates. These are considered high grade securities.

Q. Is it very generally serial maturities ?

A. They are usually serial maturities, although sometimes they are all due on a specified date.

Q. And the amount of financing that can be done in that way is somewhat limited because of the serial maturing feature or else you will have a revolving fund?

A. Well, it is limited by the fact they apply only to equipment items, rolling stock.

Q Is there not a problem also financing on a revolving ---

A There is a problem of serial maturity always and particularly with relatively short-term obligations. Other industries today are using serial maturities or sinking fund obligation which is substantially the same.

Q. Would you comment on Schedule 5 of your study, Schedule 5 of Exhibit 75?

A. First I would like to have a couple of figures inserted on Schedule 5. On line 2 under the headings of Treble A, double A and A the yields were left out and I would like to put those in.

Q. I think we can write them in as you do it. Treble A is --- ?

A. Treble A is 2.99 per cent; double A is 3.02 per cent and A is 3.06 per cent. While I am at it I would like to correct a typographical error.

Q. Just a moment. There were no issues Baa and so, therefore, the last one still remains blank?

A. That is right. Now, on line 14, the column headed "A" the 5.78 per cent should be

5.28 per cent.

Q. 5.28 per cent instead of 5.78 per cent on line 14 under the heading of A.

MR. FRAWLEY: Would you be kind enough to go over those percentages again?

MR. SINCLAIR: 2.99 per cent on treble A; 3.02 per cent on double A, and 3.06 per cent on A, and the change in line 14 under "A" from 5.78 to 5.28.

Q. Would you go on with your comments in regard to Schedule 5 as you have amended it before the Commission, Mr. Smith?

A. Schedule 5 shows the yields on equipments by Moody's ratings for the years 1950, 1951, 1957, 1958 and by months through September 1959. The yields for 1950 and 1951 were lower than yields for seasoned railroad bonds as is shown by Sheet 2 of Schedule 3. In recent years in general they have been somewhat higher which evidently reflects the general trend of new issues of the same grade yielding higher returns at issuance than the seasoned securities. This trend also represents a deterioration in the superior position which equipment trust certificates occupied at one time.

Q. Would you tell the Commission of Canadian Pacific equipment issues in recent years, and the yields of these issues?

A. Canadian Pacific sold equipments in recent years as follows:

April 1, 1953, due 1963, $25,000,000, cost 4.00%
January 2, 1954, due 1969, $25,020,000 cost 3.83%
August 1, 1954, due 1962, $17,200,000, cost 3.01%
June 2, 1958, due 1968, $20,000,000, cost 4.63%

Q. The cost of that last issue of June 2, 1958 was what?

A. 4.63 per cent.

Q. That was a ten-year issue?

A. Yes, sir.

Q. It was an issue of $20 million at a

cost of 4.63 per cent?

A. Yes.

Q. Do you wish to draw to the attention of the Commission any particular point in relation to the rates that you have referred to?

A. Yes. The significant facts about equipments are that the cost of this type of capital has increased not only with the general increase in cost of money but they have lost something of the preferred position they formerly occupied. This is illustrated by the fact that equipments were sold in 1946 and 1947 at from 1.75 per cent to 2.60 per cent.

MR. SINCLAIR: Mr. Chairman and members of the Commission, the next section of the cost of money study of Mr. Smith is in relation to preferred stock capital.

Q. Before dealing with it as it is in Exhibit 75, Mr. Smith, would you first tell the Commission whether railroads have public issues of preferred stock in recent years?

A. Railroads in the United States, as far as I can learn, have issued no preferred stock to the public in recent years.

Q. Has Canadian Pacific?

A. No, Canadian Pacific certainly has not.

Q. Now, will you deal with the yields of preferred stocks as contained in Schedule 6 of your cost of capital study? Would you turn to Schedule 6 and discuss it?

A. Schedule 6 shows yields on 10 high grade and 10 medium grade utility preferred stocks of United States utilities on certain U.S. railroad preferred stocks and on Canadian Pacific preferred stock. The yields on the utilities are as compiled by Moody's and the rating of the securities is likewise by Moody's. The yields on railroad preferreds reflect the average yields on all of the 18 railroads included in Schedule 8 which had preferred stock outstanding, except Chesapeake and Ohio Railroad. The preferred stock of that company is convertible into common and it was excluded for that reason. Six companies had preferred stocks outstanding from 1950 to 1953 and five companies for the balance of the period covered by Schedule 6.

Q. What does this schedule show as to the movement of the yields?

A. This Schedule 6 shows what we would expect, namely, an increase in yields on preferred stocks, generally speaking, during the period under review. In other words, the trend of yields on preferred stock corresponds roughly to the trend of yields on bonds but of course with the yields on the preferreds being higher than on bonds. The yields on the railroad preferred stocks were higher than the medium grade utilities. The yields on Canadian Pacific's preference stock were generally higher than the average yields on the railroad group of preferred stocks.

Q. Now, would you turn to Schedule 7 of

Exhibit 75 -- that is, your cost of capital study, Mr. Smith -- and comment on that?

A. Schedule 7 shows the yields on newly issued U.S. utility preferred stocks. These may be contrasted with the lower yields on the seasoned preferred shown on Schedule 6.

Q. That is, utility to utility?

A. Yes, sir.

Q. What has been the yield on recent preferred stock issues of utility companies in the United States?

A. As a further indication of the trend in the cost of preferred stock capital, I would like to cite the following recent issues in the United States:

> Duke Power Company, a large electric utility whose bonds are rated triple A by Moody's, issued 250,000 shares of preferred stock at competitive bidding on June 10, 1959 at a yield of 5.25 per cent.

Q. Does Moody's give any rating higher than triple A?

A. No, that is the highest.

Q. That would be the highest investor confidence rating that Moody gives?

A. Yes, and Duke is a very fine power company. It is one of my clients.

> Transcontinental Pipe Line Company, a natural gas pipeline whose bonds are

rated A, issued 150,000 shares of preferred on July 29, 1959 at a yield of 5.60 per cent.

On September 10, 1959, Community Public Service Company, an electric utility whose bonds are rated A, issued 30,000 shares of preferred at a yield of 5.60 per cent.

Northern Natural Gas Company, a pipeline company, issued 200,000 shares of preferred on October 7, 1959 at a yield of 5.60 per cent. Northern's debentures have a Moody rating of A.

MR. FRAWLEY: That will go up when they get that Alberta gas.

THE WITNESS: Northern has no bonds outstanding.

MR. SINCLAIR: Mr. Frawley says that the yield will go up when --

MR. FRAWLEY: No, the Moody rating.

MR. SINCLAIR: I just thought we should correct any implication to the contrary.

Q. Now, the next part of your cost of capital study, Mr. Smith, relates to community equity capital. What is the basic approach in determining the cost of common stock equity?

A. When it comes to common equity capital, we do not have a legal cost rate, hence we cannot use a coupon or other contractual rate to measure the cost. We must determine the cost by the use

of economic and financial data.

Q. In that answer you are contrasting, are you, the situation of common stock equity in relation to fixed interest securities and preferred stock capital?

A. That is right. Preferred stock or bonds have a legal interest or coupon rate, and from that rate you can measure the actual cost. In other words, the rate shows what has to be paid, and comparing the rate and the proceeds and market prices, and so on, you can compute the actual cost. We do not have such a coupon or fixed rate in the case of common stock. Perhaps it is a misnomer to call it "cost of common stock", but by general acceptance in the United States the way I have defined the amount applicable to common stock has come to be known as "cost of equity capital".

Q. Cost of equity capital?

A. Yes, sir.

Q. Now, in determining the cost of equity capital what have you done in the study as you have set it out in Exhibit 75?

A. In determining the cost of equity capital, among other things, I have made studies covering 18 railroads in the United States, selected in the manner hereinafter described, Canadian Pacific and 25 railroads for which Moody's publishes group data.

Q. On what basis did you select the 18 railroads that are set out in the study, Exhibit 75?

A. In selecting the 18 railroads I have used in the study I applied the following test for the year 1950:

(1) the road had a net investment in plant of $300,000,000;

(2) the revenues amounted to as much as $100 million;

(3) the road paid dividends in that year.

I consider the railroads selected represent a very good sample of the railroad industry in the United States and Canada.

Q. Before we move into this part of the study it was felt it would be of assistance if the terms which you used in determining the cost of common stock equity capital were explained. Now, the first is colloquially known as E.P.R., the earnings-price ratio. What do you mean by that?

A. E.P.R. stands for earnings-price ratio. The earnings-price ratio shows the percentage relationship of earnings on a share of stock to the market value of the stock. Thus if a stock earned $10 and has a market value of $100, the earnings-price ratio is 10. If the stock sells for $125 with earnings of $10, the earnings-price ratio would be 8, that is to say, 8 per cent of $125. Mechanically, the earnings-price ratio is arrived at by dividing the market value per share into the earnings per share. In a nutshell, it represents the percentage of earnings to market value of the

stock at a particular time.

Q. Now, another term you use is "yield". Would you explain that term, please?

A. The yield is the relationship on dividends on stock to market price of the stock. Thus, using the illustration I just employed, if stock sells at $100 a share and dividends thereon amount to $6 a share, the yield is 6.0 per cent; if the stock sells for $125 a share, the yield is 4.8 per cent.

Q. The next term you use is "pay-out". Will you explain that term as you use it, please?

A. The pay-out represents the relationship of dividends paid to earnings available on stock. Thus, if $12 is earned on a share of stock and dividends of $6 are paid, the pay-out is 50 per cent. If the earnings amount to $10 a share and dividends of $6 a share are paid, the pay-out ratio is 60 per cent.

MR. FRAWLEY: When you say "earnings on a share of stock", how do you determine that?

THE WITNESS: That is determined from the published financial statements of utilities which are usually certified to by chartered accountants or C.P.A.'s in which they show the net earnings of the company, and then they divide the shares outstanding and get the earnings per share. It represents the actual earnings in a particular period of time.

MR. FRAWLEY: Thank you.

MR. SINCLAIR: Q. Mr. Smith, would you tell the Commission, please, why earnings-price ratios, yields and pay-outs are considered by you to be important in developing cost of ordinary stock equity?

A. Earnings-price ratios, yields, and pay-outs are very important considerations in appraising stock. The yield is very important because many investors buy stock mainly for income, which is to say dividends. The earnings are very important because the earnings show the margin of safety for the dividend and also the prospects of increasing the dividend, or the possibility of a reduction therein. Both yields and earnings-price ratios, therefore, are very significant factors in influencing the judgment of investors in purchasing common stocks. The pay-out ratio is important because obviously of two companies one which pays out practically all of its earnings and one which pays out one-half of its earnings, other things being equal, the company which pays out only one-half of the earnings is more attractive because of the safety factor and of the possibility of increasing dividends.

Q. Now, do you apply judgment in developing the weight to be given to these factors?

A. It goes without saying that judgment must be applied to all studies relating to common stock earnings-price ratios, yields and pay-outs. Among other things, we know that, generally speaking, stocks are bought not only for the current dividends but also on the basis of prospective earnings and

dividends. There is no way of measuring accurately what weight investors give to each factor but it is known that these factors are taken into account.

Q. Are capital gains a factor to be taken into account, Mr. Smith?

A. Yes, in addition, many investors buy stocks for the purpose of realizing capital gains. We know as a matter of fact that this factor is extremely important in many situations. Where the history of a company shows availability of large capital gains over the years through substantial appreciation in the market value of the stock, the stock frequently sells on a very low yield basis. This is the situation today with respect to a great many common stocks because there are numerous companies, utilities as well as industrials, whose common stocks, on a current dividend basis, yield lower returns than the bonds of the same company. Where the stock of a company yields less than the bonds of the same company, obviously investors in the stock are buying on the basis of an increase in earnings and dividends, on the basis of a prospective increase in market value, or both.

THE ACTING CHAIRMAN: Mr. Sinclair, I haven't got Mr. Toole's precis here; how long will he be?

MR. McDONALD: He will be very short.

THE ACTING CHAIRMAN: I was thinking whether we should go through until 12.30, or if we adjourned now, do you think we can get through with Mr. Smith

and Mr. Toole this afternoon?

MR. SINCLAIR: I would think so.

MR. McDONALD: Mr. Toole will be very short. I will file the precis and and get it on the record and take it as read, and then he will be back for cross-examination in January.

THE ACTING CHAIRMAN: Then, I think we will adjourn now.

---Luncheon adjournment.

(Page 2842 follows)

---On resuming at 2.00 p.m.

THE ACTING CHAIRMAN: All right, Mr.Sinclair.

MR. SINCLAIR: Mr. Chairman, this morning in answer to a question raised by my friend Mr. Cooper in regard to Chart 1 as to where the year 1956 was, the witness Mr. Smith said that there was a break in the graph to save space, and I am dealing with Chart 1 of Exhibit 75.

Now, if you would look at that I think what the witness had in mind, obviously, was that there were two different types of graphs on Chart 1 of Exhibit 75.

THE ACTING CHAIRMAN: It just covers four years?

MR. SINCLAIR: But it is by months, sir, and the first graph is by years, and so by looking at it you will see 1956 is there by the year, and also, 1957 in the next graph is shown by months.

Q. Is that correct?

A. Yes, that is correct.

MR. SINCLAIR: And you will see that the first month is not an axis of the graph on the second series, but the axis -- or, what would be not really the axis, but the most right end or side of the first graph, is a year.

Q. Now, just before recess for luncheon, Mr. Smith, we were dealing with the ascertining of cost of ordinary stock equity capital, and you had explained the terms you used and you had also

explained the factors taken into account in arriving at cost, including the latter one which you dealt with, which was capital gains.

Now, will you turn to Schedule 8 of your cost of capital study -- Schedule 8 of Exhibit 75 -- and comment on that, please?

A. I show in Schedule 8 the earnings-price ratios, yields and pay-outs for 18 railroads, Canadian Pacific and Moody's 25 railroads for the years 1950 through 1958 and for September, 1959. The data are shown for each of the 18 companies.

I would like to explain the procedure followed by reference to the year 1958, Sheet 3 of the Schedule.

Q. Sheet 3 of Schedule 8?

A. That is right.

Q. Exhibit 75.

THE ACTING CHAIRMAN: Mr. Sinclair, would the pay-outs there be the pay-outs in respect of rail earnings-price income, or is it corporate?

MR. SINCLAIR: On Canadian Pacific it is corporate.

Q. That is right?

A. Yes, that is right.

COMMISSIONER ANSCOMB: That applies to all of them, I take it?

THE WITNESS: That is right. You can't very well earmark dividends by sources of income.

THE ACTING CHAIRMAN: I just wanted to make that clear.

MR. SINCLAIR: Q. Mr. Smith, in that

regard whatever advantage would flow to Canadian Pacific from these non-rail activities would be reflected in the costing that you have done for equity capital?

A. Yes, it would be reflected in the price of the security, the ordinary stock.

Q. And from what you know of the company would the effect of that reduce or increase the cost of capital to Canadian Pacific?

A. That is a favourable factor, without doubt, and results in a higher price for the stock than would otherwise be the situation.

Q. And therefore the lower cost?

A. Therefore the lower cost.

Q. Will you go on, please,turning to Sheet 3 of Schedule 8?

A. The earnings-price ratio for Atchison, Topeka and Santa Fe for 1958 is shown as 11.06 per cent. The earnings per share for 1958 amounted to $2.51. The average of the high-low market price for 1958 was $22.69 per share. The earnings therefore amounted to $11.06 per cent of the average market price.

Q. Now, the dividend in 1958?

A. The dividend paid in 1958 by Atchison, Topeka and Santa Fe amounted to $1.40 a share. The yield accordingly was 6.17 per cent of the average market price. The dividend of $1.40 was 55.77 per cent of the $2.51 earned per share; hence the payout was 55.77 per cent.

Q. Now, turning to Canadian Pacific that

is shown on line 20 of sheet 3 of Schedule 8 and Exhibit 75, would you please draw that to the attention of the Commission?

A. The data for Canadian Pacific are shown on line 20. On line 21 the statistics for Moody's 25 railroads are portrayed. Moody's compiles a special statistical series for 25 railroads and the earnings-price ratios, yields and pay-outs on line 21 are computed from such statistical data.

Q. Now, could we turn back to sheet 2 of Schedule 8 of Exhibit 75, and would you comment on that, Mr. Smith, please?

A. On Sheet 2 of the Schedule, earnings-price ratios, yields and pay-outs are shown for each of the 18 companies, for Canadian Pacific and for Moody's 25 railroad corporations for the years 1953 to 1955. Similar data are shown for the years 1956 to 1958 on Sheet 3.

Q. That is the one we were dealing with a moment ago. Now, Sheet 4?

A. The figures for September 30, 1959, Sheet 4, are computed in a somewhat different fashion. The earnings-price ratios are computed by relating the closing market price on September 30, 1959 to the earnings per share for 1959 as estimated and published by Standard and Poor's Corporation, a well-known financial and statistical organization. The yields are also related to the closing market price on September 30.

Q. And until the financial reports of

the various companies are out, what you have done on sheet 4 of Schedule 8 is the commonly accepted method in this type of appraisal?

A. Yes. I might add that railroads follow a practice of reporting by months, the earnings for six months, seven months, nine months, and so forth. Many other corporations report income for the twelve months ended on June 30, and so forth, but Standard and Poor take the earnings for the first nine months of this year as compared with nine months of last year and computes the trend, and

then from that computes a yearly figure which is published in their stock guides, and I have used that yearly figure.

Q. Thank you. Now, would you please turn to Schedule 9 of your cost of capital study and discuss that?

A. I have summarized on Schedule 9 the figures appearing on Sheets 1 to 4 of Schedule 8. The first column after the years shows the earnings-price ratios for my 18 company group. It will be noted the ratio for 1950 was high, 23.71 per cent. This was a continuation of the unsettled conditions from the depression in which about one-third of the railroad trackage in the United States was run by receivers.

There was a downward trend from 1950 to 1954 when the ratio of 10.93 per cent was experienced. The ratios for 1955, 1956 and 1957 were somewhat above the 1954 ratio. The ratio for 1958 is shown at 9.39 per cent and for September, 1959 at 9.53 per cent. By reference to Sheet 3 of Schedule 8 it will be seen that the ratios for 1958 for New York Central, Pennsylvania and Reading were 2.91 per cent, 1.72 per cent and 1.53 per cent. These figures illustrate that future prospects play a significant role in the motivation of investors. When these unrealistic figures are eliminated the average becomes 11.08 per cent instead of 9.39 per cent. Similarly, if the low figure of 4.41 per cent for Pennsylvania is eliminated from the September, 1959 data, the average earnings-price ratio for my group of

companies becomes 9.85 per cent instead of 9.53 per cent.

Q. Now, what are the trends that you find in these various groups that you have been discussing?

A. The earnings-price ratios of Moody's 25 railroads in general followed the trend of the 18 company averages and were very close to such averages for the year 1954 and subsequently.

Q. Would you compare the Canadian Pacific Railway situation with Moody's and the 18 companies?

A. The earnings-price ratios of Canadian Pacific fluctuated more widely than the others. They were completely out of line with the two groups for the years 1952 to 1954 or 1955. They have been lower than for the two groups throughout the period. I believe that the "other income" of Canadian Pacific, which is a very important factor in its earnings per share, and which was comparatively low in the years 1953, 1954 and 1958, has an important bearing on the earnings-price ratios.

Q. Now, Mr. Smith, the middle section of Schedule 9 of Exhibit 75 has the heading for the three columns which deal with the yields for the similar groups you have been discussing with respect to earnings-price ratios. Will you please draw to the Commission's attention your views on this?

A. The average yield for the 18 companies for the period covered by the study was 6.26 per cent. In this connection I would like to refer to Sheet 4 of Schedule 8 showing the yields

as of September 30, 1959. Some of the yields were very low. Thus investors would not buy Atlantic Coast Line stock at a yield of 3.8 per cent, Illinois Central and Norfolk and Western at yields of 4.3 per cent, Northern Pacific at 4.1 per cent and Pennsylvania at 1.5 per cent, when high grade bonds can be obtained to yield more than 5 per cent, except on the basis of future prospects. Some of the lower yields can only be explained on this basis.

Q. Is that a recognized factor, Mr.Smith, by financial analysts?

A. Yes, that is well recognized.

Q. Now, you were talking about high grade bonds yielding more than 5 per cent; could you give us some examples?

A. Yes, I can. In this connection Georgia Power Company issued $18 million of bonds rated A by Moody's on September 17, 1959 at a yield of 5.65 per cent. New England Telephone and Telegraph Company on September 21, 1959 issued $45 million debentures rated double A at approximately 5.62 per cent. Boston Edison Company on October 1, 1959 issued $15 million bonds rated triple A at a yield of approximately 5.17 per cent, and on November 26th this year Bell Telephone Company of Canada issued $35 million of mortgage bonds at a yield of 6¼ per cent.

Q. Now, Mr. Smith, would you deal with the yields of Moody's 25 rails as compared to the 18 railroad companies?

A. The yields on Moody's 25 rails were generally in line with my 18 company group except for the year 1955. Moody's averages should be lower for its series includes statistical data for all 25 companies even though some of the companies did not pay dividends in certain years. In the 18 company group I did not include, for a given year, any company which did not pay a dividend in that year. The average yield for the Moody group of companies for the period covered in the study was 5.90 per cent.

Q. What about yields on Canadian Pacific?

A. While the trend of yields on Canadian Pacific ordinary stock which are based on New York Stock Exchange quotations, generally paralleled those of the two groups, they were materially lower for the years 1952 to 1956. Even with what I consider abnormally low yields during the years 1952 to 1956, the average yield for the entire period from 1950 was 5.51 per cent. On the basis of quotations on the Montreal Stock Exchange, the yields were: 1956, 4.55 per cent, 1957, 6.21 per cent, 1958, 5.78 per cent and September 30, 1959, 5.88 per cent.

(Page 2854 follows)

Q. Now, Mr. Smith, we would like to deal with the last segment of Schedule 9, namely, pay-outs.

A. The pay-outs were much higher on the average for Canadian Pacific than for the two groups of companies. The fluctuations in pay-out were also much wider in the case of Canadian Pacific, ranging from a low of 37.64 per cent in 1950 to a high of 77.32 per cent in 1954 with an average for the period of 58.94 per cent.

Q. Yes. Now, turn to Schedule 10, Mr. Chairman and members of the Commission. What is the purpose of this schedule, Mr. Smith?

A. In Schedule 10 I compare earnings-price ratios, yields and pay-outs of industrials, utilities and railroads. The figures are computed from data published by Moody's for each series. The significant conclusion I draw from the study is that railroads had higher earnings-price ratios and higher yields than the other two groups. This is strong evidence of the greater risk inherent in railroad equities, for which higher compensation is required in order to protect the integrity of railroad equities and thus enable the industry to attract equity capital on reasonable terms.

Q. And in that last sentence of yours, would that higher compensation be translated to cost?

A. It is the same thing as I have used it here.

Q. Specifically, would you draw to the

Commission's attention the comparisons in that Schedule 10?

A. It will be noted among other things, that the yields on utilities have been low in recent years. Thus the yields in 1957, 1958 and as of October 23, 1959 were 4.92 per cent, 4.33 per cent and 4.05 per cent respectively. By reference to Schedule 4 it will be seen that the yields on new issues of utility bonds averaged 4.74 per cent in 1957, 4.21 per cent in 1958 and I have cited high grade issues in 1959 which sold to yield more than 5 per cent.

Q. What is your comment about the situation that has been noted by many people of risk securities of junior character yielding less than higher securities?

A. This condition - of senior debt securities yielding higher returns than junior risk securities - is further illustrated by certain studies of Moody's published regularly in the Federal Reserve Bulletin. These studies show that yields on both industrial and public utility common stocks for the years 1956, 1957 and 1958 were lower than the yields on corporate bonds. This condition is explained by the appeal of what are known as "growth" stocks, that is to say, stocks on which the earnings are expected to increase and the market price to advance in about two to five years. Security analysts and financial services constantly emphasize such growth potentialities.

Q. Would you give the Commission an example that has clearly shown the influence of growth and with relation to the yield?

A. An excellent example of the influence of growth is the common stock of Baltimore Gas and Electric Company. The average of the high-low price of that stock in 1954 was $29.13 a share. Dividends at the time amounted to $1.40 a share annually. The yield was, therefore, 4.80 per cent. In 1959 the dividend is at the rate of $2 a share so that the yield on the basis of the average price for 1954 is 6.87 per cent. More important to many investors is the fact that as of October 30, 1959, the market price was $51.75 a share, an increase of some 78 per cent or 15.6 per cent a year on the average.

Q. Now, this example you have given of a company that happens to be in your own home town -- could you find other examples in Canada and in the United States?

A. Yes. That illustration could be repeated for numerous common stocks; it is the real explanation for the low current yields on many of them. It is apparent that if growth is not realized and the stock thereafter is purchased for current returns only, the yields will reach their proper levels with respect to yields on senior securities, that is to say, higher yields will ensue on the stocks.

Q. Mr. Chairman and members of the

Commission, I would like to turn to Schedule 11 of Exhibit No. 75 and ask Mr. Smith to discuss that for the assistance of the Commission, please.

A. Schedule 11 shows the percentages earned on common equities of gas and electric utilities in the United States and dividends on such equities, stated as percentages of the equities. The electric utilities comprise all the privately owned electric utilities in the United States with revenues in excess of $250,000 annually. The gas companies are the gas companies subject to the regulatory jurisdiction of the Federal Power Commission, hence they represent pipeline companies primarily. The gross gas utility plant of the companies in 1958 amounted to $8 billion in round figures. The investment in plant by the electric utilities was $36 billion.

The rates of gas and electric companies in the United States are regulated. Their average returns, therefore, are not generally excessive by regulatory standards, nor are they depressed.

Q. Mr. Smith, in saying that, has there been a general recognition in the regulation of these utilities as to their investment and the cost studies such as you are dealing with here in the fixing of individual rates as well as overall rates?

A. Well, the rates of the natural gas pipeline companies are fixed by the Federal Power Commission, and the Federal Power Commission has been fairly active in regulating that, and regulates on a net investment basis. The rates of electric

utilities are fixed chiefly by state commissions, and the majority of state commissions use the net investment basis. But there are some using the fair value rate basis, and there is one commission, namely, Ohio, which employs a rate basis computed on reproduction costs, but commissions like New York, Wisconsin, California, use the net investment basis in fixing reasonable compensation to the company.

Q. That is overall?

A. Yes.

THE ACTING CHAIRMAN: It would be true that these utilities have benefitted very much from the expanding economy of the country, your country and mine?

THE WITNESS: Yes.

THE ACTING CHAIRMAN: But, by the same token, rail has been encroached upon by other forms of transportation?

THE WITNESS: I would agree readily that rails have had more competition, although my friends in the gas business deny that; they deny that coal and oil represent the greatest kind of competitive force. But I am more on your side in that kind of thing. But I have this feeling: I think the railroads in the United States have suffered from many things, and we are taking drastic action to try to put them on the level of other industries. We have a great stake in the railroads; our economy depends on good transportation, and we can't have that if the industry is going to be sick.

THE ACTING CHAIRMAN: The history of the last 20 years of utilities has been against rail in favour of those other ones.

THE WITNESS: I wouldn't say utilities against rail. The growth of the electric utilities has meant business for rail, because they use so much coal for the generation of electricity. The carrying of coal is still one of the big revenue items, and they don't want them using natural gas in generating electricity.

THE ACTING CHAIRMAN: What I have in mind is that highways, pipelines, seaways and airlines, and that sort of thing, encroach on rail.

THE WITNESS: They encroach on rail, but in some cases they make additional traffic available. When you bring in airlines, I think airlines make some business. They encroach a good deal on passenger traffic, yes. The only encroachment on railroads by natural gas pipelines is where the pipelines sell gas for boiler fuel which takes the place of coal.

THE ACTING CHAIRMAN: Looking to the future, can you give us any idea of your view as to air cargo, what damage or otherwise there will be in the next 20 years?

THE WITNESS: I can't very well because I think it is tied up in another field where I get into trouble, and that is atomic energy. You may have atomic-powered locomotives carrying tremendous freight trains at high speed. I think you are going

to have them transporting through air much bigger planes than we have now. That is one avenue of approach which I can't go into too much now; but when you consider the North Pole, you can see a tremendous future where atomic energy is used. I can project it this way, that in my foreseeable future I can't see any substitute for rail transportation, with the bulk of the large traffic being carried by the railroad. I think everyone in the United States who has studied this matter is very much worried about our railroads in time of defence. We rely on them in times of emergencies.

THE ACTING CHAIRMAN: Would you not say that that applied more even to Canada?

THE WITNESS: I don't want to pose too much as an expert on Canadian affairs, but I will say this to you, that in my studies of Canadian railroads, which I began in 1952, I think the railroads have made a tremendous contribution to the economy of Canada, and I hope they will continue with it.

COMMISSIONER BALCH: You said that the American railroads were in a sick condition. Is there any future for the American railroads making a come-back?

THE WITNESS: I think there is. I would like to think so. At least the general thinking in Congress and elsewhere is that they ought to be given a reasonable opportunity to come back, and I agree with that. First of all, the American railroads, unlike the Canadian Pacific -- there is a lot

manipulation in the railroads. There are the famous names, involving the Pacific railroads, the big scandal of Credit Mobilier, where millions of dollars were poured into the water.

Secondly, depreciation practices were not started until the 1940's. Compared with Canadian Pacific, the Board of Transport Commissioners has made a study of it, and depreciation practices have been much sounder. The railroads are getting their accounts in good shape now, and, given opportunities as Congress said they should have, they have a reasonable chance to bring this industry into a healthy stage, and certainly I am, and a great many others are, rooting for them to be able to do that.

THE ACTING CHAIRMAN: I wonder if the Commission might have an informal meeting with Mr. Smith.

MR. SINCLAIR: We would be very happy to arrange that, sir.

Q. When you were speaking of your friends in the natural gas industry and the competition, do your friends in the natural gas industry think they have got much competition from coal and oil?

A. Yes, they do. They are very fond of citing one example, where the Northern Natural Gas Company fought to serve the Black Dog generating plant, and they had a special drive to serve that plant to take it away from coal. They got the authority, but coal is being burned in the plant

today. All I can say is the way they prey upon me and their troubles of competition -- they seem to be pretty large.

Q. Their competition problems?

A. Yes. I went to Birmingham, Alabama, and I was working with the natural gas company which serves gas to industrials, and some of these rates are going to be on contracts not extending beyond a one-month period because of the competition with other fuels. Of course, that is a very serious thing.

THE ACTING CHAIRMAN: When we meet, of course, nothing that Mr. Smith says will be used in evidence against him.

THE WITNESS: When we meet, sir, I will represent Charles W. Smith and no one else.

MR. SINCLAIR: When we were talking about air cargo, Mr. Chairman, I thought Mr. Smith's answer might have been covered to some degree by the fact that on the way up here they changed planes and he lost his bag, and so he is working here --

THE ACTING CHAIRMAN: That was not C.P.R.

MR. SINCLAIR: No. Unfortunately we haven't got a route across the border yet.

(Page 2866 follows)

THE ACTING CHAIRMAN: I was asking Mr. Smith to meet with us and I am sure when Mr. Frawley's experts come we will be glad to see them in the same way.

MR. FRAWLEY: Mr. Chairman, I will be very glad to place my experts at a round table conference with the Commission. I am sure they will be as helpful as my friend's experts.

THE ACTING CHAIRMAN: All we want to do is get things proper.

MR. SINCLAIR: I can understand that. That is what I understood by your request and also what we had in mind.by saying we would be glad to facilitate that in any way we can.

Q. Now, looking as this Schedule 11, Mr. Smith, would you please discuss that?

A. The schedule shows that natural gas company earnings on common equity were relatively stable ranging from a low of 11.2 per cent in 1954 to a high of 13.6 per cent in 1955 and with an average of 12.4 per cent for the period. The common equities consisted of the amounts in the common stock and surplus accounts, averaged for each year shown on the schedule, and on the average represented 31.4 per cent of total capitalization for the nine-year period portrayed.

The dividends appropriated by the gas companies ranged from 7.5 per cent of common equities to 8.9 per cent with an average for the period of 8.1 per cent.

The earnings on the common equities of the electric utilities were remarkably stable ranging from a low of 9.5 per cent to a high of 11.0 per cent and an average of 10.47 per cent. The dividend appropriations of the electric utilities averaged 7.6 per cent for the period. The common equities amounted to 37.1 per cent of total capital for the period.

Q. Now, would you turn to Schedule 12 of Exhibit 75 and this deals with corporate equities and please discuss them. Corporate equities include what?

A. Corporate equities as shown on Schedule 12 include preferred, common and surplus, which is a little different from the equities on the previous page which is restricted to common stock and surplus.

Q. And Schedule 12 deals with what groupings of corporations both United States and Canada?

A. It deals with all manufacturing corporations in the United States and it deals with business corporations in Canada. The U.S. data are compiled from comprehensive samples by the two federal agencies shown on the schedule. Thus the sample in the first quarter of 1957 contained approximately 9,200 corporations. The number of companies varies from time to time.

The Canadian study includes somewhat more than 300 corporations, with variations in the number of companies included for most years. For the years 1954 and 1955, 344 corporations were

included and for the years 1956 to 1958 there were 321 corporations.

Q. Now, Mr. Smith, what is the situation with regard to Canadian corporations in 1959, which is not shown on Schedule 12?

A. According to the Financial Post Market Data, the earnings on corporate equities of Canadian corporations in the first quarter of 1958 were down 15.8 per cent from the same period of 1957; down 12.3 per cent in the second quarter; up 0.4 per cent in the third quarter and up 24 per cent in the fourth quarter.

COMMISSIONER MANN: Twenty-four per cent?

MR. SINCLAIR: No; but in the third quarter 0.4 per cent.

THE WITNESS: 0.4 per cent in the third quarter.

MR. SINCLAIR: Q. And 24 per cent in the fourth quarter?

A. That is right.

Q. You have broken that 1958 down into four quarters for the purpose of making some relationship with quarters in 1959?

A. Yes, sir. The same source stated that the earnings were up 16.9 per cent in the first quarter of 1959 compared to the same period in 1958.

Q. Now, would you deal with average earnings for United States and Canadian corporations for the years 1950 through 1958?

A. The average earnings for the U.S.

corporations for the years 1950 to 1958 was 11.40 per cent whereas the average for the Canadian corporations was 10.49 per cent.

Q. Mr. Smith, what is your conclusion as to the cost of Canadian Pacific ordinary stock equity capital?

A. I conclude from my study that the cost for that part of the ordinary stock equity which is allocated to the rail enterprise is between 9¼ per cent and 9½ per cent. In reaching this conclusion I am influenced by the fact, among others, that the price of capital, even capital devoid of risk, has increased substantially in recent years. We can buy U.S. Treasury securities which will yield close to 5 per cent and we can invest in Government of Canada securities which will yield higher returns. High grade corporate bond issues are available in the United States which yield more than 5 per cent.

It is my conclusion that the dividend on the equity should be approximately 6 per cent in order to protect the financial integrity of the company and thus permit it to attract capital in the amounts reasonably required and when required, and on reasonable terms and conditions. With a pay-out ratio of between 60 per cent and 65 per cent, the resulting cost of the equity is between 9.23 per cent and 10 per cent. I have narrowed the figures to 9.25 per cent to 9.50 per cent.

Q. That is your 9¼ per cent to 9½ per cent that you mentioned a moment ago?

A. That is right.

Q. Now, as this Commission knows it is necessary in dealing with Canadian Pacific to deal with the rail enterprise, and as that has been set up and its investment found by the Board of Transport Commissioners which was a marked advantage that flowed from the last time you gave evidence, the Board did establish the net investment in the rail enterprise of Canadian Pacific and I would like you to turn to Schedule 13 and comment on that.

A. Schedule 13 is a balance sheet as of December 31, 1958, of Canadian Pacific. The balance sheet segregates the rail and non-rail enterprises.

Q. Now, will you turn to Schedule 14 which ties the balance sheet in Schedule 13 into the net investment rail as we know it and as it is calculated on the basis of the Board of Transport Commissioners findings?

A. Schedule 14 shows a computation of the net investment in the rail enterprise made on the basis approved by the Board of Transport Commissioners. From the total rail investment shown on Schedule 13 there have been deducted depreciation reserves, the tax equalization reserve applicable to rail and the donations and grants disallowed by the Board of Transport Commissioners. The depreciation reserve has been adjusted so as to eliminate the excess of user depreciation over straight-line depreciation due to the Board disallowing user depreciation for rate-making purposes.

The figures contained in Schedule 14 were developed from the records of Canadian Pacific.

Q. Now, would you turn to the final schedule of Exhibit 75 and explain this to the Commission? I wish to draw this particularly to the attention of the Commission because I think it contains some very significant material.

Would you go through this rather slowly, Mr. Smith?

A. The final Schedule (Schedule 15) in the cost of capital study shows the cost of debt, preferred and ordinary stock equity capital allocated to the rail enterprise.

The first item on that schedule shows the cost of capital raised through the issuance of equipment trust certificates. Part of the total equipment obligation is payable in U.S. funds and part in Canadian funds. The amount payable in U.S. funds is 1.12 per cent of total capital. The annual cost of interest thereon is 3.72 per cent. Accordingly, 0.04 per cent on total capital was necessary to service this debt as of December 31, 1958.

Q. That is actually a cost of service?

A. That is right. In other words, 0.04 per cent of total capital is required to pay the interest on these equipment obligations, the interest being payable in United States funds.

Q. Yes.

A. Similarly, equipments payable in Canadian funds constituted 2.76 per cent of total capital, and with interest cost of 4.10 per cent, required 0.11 per cent on total capital.

Q. Yes, and again that is the cost of servicing this amount of equipment in Canadian funds?

A. Yes, sir.

Q. You go on to leased lines securities not owned.

A. The leased lines securities not owned constituted 4.21 per cent of total capital and had an annual cost of 2.61 per cent as a group, and required 0.11 per cent on total capital.

Q. That is again as a group?

A. Yes. The collateral trust bonds constituted 8.74 per cent of total capital, had an annual interest cost of 4.36 per cent, and required 0.38 per cent on total capital.

Q. Now, would you deal with the perpetual 4 per cent consolidated debenture stock of Canadian Pacific?

A. The perpetual 4 per cent consolidated debenture stock constituted 15.92 per cent of total capital with an annual interest cost of 2.83 per cent, a remarkably low cost for reasons I will discuss presently. The percentage on total capital required to service this debt was 0.45 per cent.

Q. Now, would you deal with total debt?

A. Total debt was 32.75 per cent of total capital as of December 31, 1958. It had an annual interest cost of 3.33 per cent and required 1.09 per cent on total capital.

Q. May I interrupt you there to say, is it correct to draw the conclusion from what you have said that the actual cost of servicing this debt, some $471.5 million, the actual cost of that debt

money was 3 1/3 per cent?

A. That is right, sir.

Q. Yes?

A. And it is completely out of line with current costs of debt capital. It is derived largely from low costs embedded in the past and reflects the significant effect of payments in sterling. Additional debt capital under present conditions would obviously cost a great deal more.

Q. Is it correct to say that that cost, Mr. Smith, is substantially below the cost of risk-free financing by governments?

A. Yes, it is; it is an extremely low figure.

Q. Now, then, would you deal with the preference stock which is shown on line 15, being some 121.3 millions in the Canadian Pacific rail capital; will you deal with that, please?

A. The cost of preference stock capital is phenomenally low -- 2.53 per cent. If the company could issue the same kind of preference stock today, the cost would not be less than 7 per cent. The per cent on total capital, at the cost of 2.53 per cent, required to service this stock is 0.21 per cent.

Q. Is it of significance, Mr. Smith, that here imbedded in the Canadian Pacific capital structure and given full weight by you in your cost study, that preference stock is substantially below, in your study, the cost of debt?

A. Yes. Dividends on the preference stock, like the interest on certain of the debt obligations, are payable in sterling. In computing the cost of railway capital to Canadian Pacific I have used the actual cost to the company based on exchange rates as at December 31, 1958, which means I have given effect to the low cost of sterling in Canadian funds. Thus the combination of a low dividend rate, 4 per cent, with low cost of sterling, brings about the fantastically low cost of 2.53 per cent for the preference stock capital.

Q. Now, what about the ordinary stock capital in the Canadian Pacific rail of 847.1 million?

A. For reasons which I have already given, in my opinion the rate of cost for ordinary stock equity capital is between 9.25 per cent and 9.50 per cent. Accordingly, in my opinion, the overall cost of capital for the rail enterprise should be between 6.74 per cent to 6.88 per cent.

Q. Now, in dealing with that how do you consider the cost that you have shown for ordinary stock capital?

A. Well, all of these figures, in my opinion, include only the bare bones cost, and that is particularly true of ordinary stock equity.

Q. If you were looking at a case involving rate of return or overall earnings, such as you have done at other times, would your approach be any way different in dealing with this matter?

A. Well, the approach would be somewhat

the same, and there would be different items which I would have to take into consideration.

Q. Which you haven't taken into consideration here?

A. That is right.

Q. Such as?

A. Well, in determining rate of return, an allowance is customarily made for cost of floating stock and for under-pricing or market pressure which would be associated with the issuance of additional Canadian Pacific stock. Moreover, a rate of return determination would take into consideration any additional senior securities planned to be issued in the relatively near future. Such securities would entail a much higher cost than the average cost of senior securities outstanding as of December 31, 1958, as I have previously shown.

Q. Now, is it correct to say, in dealing with all debt and preference stock capital, you have taken and given full weight and advantage to the historical cost of that capital rather than trying to relate it to present costs?

A. That is right.

Q. When you come to equity capital do you, as a financial analyst and as a financial adviser, make any distinction between equity capital raised by the issuance of stock and that arising from a reinvestment of earnings?

A. I make no distinction between the capital raised directly from stockholders through the

sale of the stock and that raised indirectly through investment of retained earnings, and none can logically be made, in my opinion. Every dollar invested in a diesel locomotive, for instance, is capital which must be compensated. Thus, if the money invested in a diesel locomotive is raised in part through issuance of debt securities, in part through the sale of ordinary stock, and in part through the investment of retained earnings, no distinction can reasonably be made between or among these sources of investment such as to hold that part of the capital involves a cost or sacrifice and the other part is free. In my opinion, it makes absolutely no difference, in determining the cost of capital, whether the capital comes directly from stock sold to stockholders or whether it is derived indirectly from stockholders in the form of retained earnings: the important thing is that the capital is invested in the rail property which is used in the public service.

Q. Now, in the United States and before these regulatory commissions, of which you have been an officer, an adviser and a witness, is there any distinction made by these tribunals in their treatment of cost of capital arising from the sale of stock, and capital represented by retained earnings?

A. It is the standard practice of regulatory commissions in the United States without exception, I believe, to treat retained earnings invested in utility plant as invested capital. I would like to add at this point that I am making that statement

because I was in probably the only case where a serious attempt was made not to allow the retained earnings on invested capital; it was a case before the District of Columbia Commission, and the Commission disagreed with the contention which was made by another federal government agency and the case went to the Court of Appeals for the District of Columbia, which upheld the Commission, and the Supreme Court of the United States refused to review the case.

THE ACTING CHAIRMAN: What is the citation?

THE WITNESS: The case was in 1946; it was a case that involved the Potomac Electric Power Company and the General Service Administration, and it was the government which took the case to court, and I will be glad to give you the exact citation, I will supply it to Mr. Sinclair.

Q. And I will give it to Mr. Cooper. Now, in that case, Potomac versus General Service Administration, the outcome of that litigation was that reinvested earnings were recognized as capital which it was entitled to a return, along with capital rates from sale of stock; is that correct?

A. That is right, and the statement was made by the Court, I believe, that no citation to the contrary was given.

Q. Now, in view of the work that you have done in this regard and the studies you have made concerning the cost of capital to Canadian Pacific, would you express your views as to the rate that was used in the cost study for the costing of grain, as

these cost studies have been presented to the Commission?

A. In view of the facts and opinions expressed previously in this testimony the cost of money of 6½ per cent used in the cost study for grain and grain products moving at statutory and related rates to export positions in western Canada is not excessive, in my opinion.

MR.SINCLAIR: That concludes Mr. Smith's evidence, and the Commission has ruled that your cross-examination and the questions to be directed to you by my friends Mr. Cooper and Mr. Cumming on behalf of the Commission, is to be deferred until the Commission reassembles here in Ottawa commencing on January 11th.

THE ACTING CHAIRMAN: Thank you, Mr.Smith, and we will look forward to having you back.

---Short recess.

(Page 2885 follows)

MR. FRAWLEY: May I take just a few minutes to refer back to the matter concerning which I spoke to the Commission this morning, and that was the cost study on Alberta coal. At that time you will remember that my friend raised an objection, and it became very doubtful whether or not the matter was a public matter and I abandoned entirely any further comments. I have consulted the official record of the Board of Transport Commissioners and I find that this matter is recorded under File No. 27425.90, and I find on the 10th June, 1952 there was a round-table conference re Alberta coal in that file number matter before Chief Commissioner Mr. Justice John D. Kearney and Commissioner Frank M. MacPherson. Present were Mr. R. Kerr, Q.C., Assistant Counsel; Mr. D. A. Scott, Director of Bureau of Transportation Economics; and Mr. L. J. Knowles, Special Advisor; and also Nelson R. Butcher and Company, official reporters, were in attendance. The appearances were Mr. J. J. Frawley, Q. C., for the province of Alberta; Mr. K.D.M. Spence, for the Canadian Pacific Railway Company; and Mr. A. K. Dysart, for the Canadian National Railways. I find at that time that Dr. Ford K. Edwards was at this round-table conference, and I would ask the Commission to refer to Volume 901 of the Board of Transport Commissioners, pages 3321 extending through to page 3349(k).

At that time the subject of the discussion was the application which I and the Western Canada coal operators had made to the Board to undertake a

cost study of the movement of coal from Alberta to Ontario, and Dr. Edwards was there to discuss with the Board the possibility of the Board's Bureau of Transportation Economics' undertaking that coal cost study. At that that time, on the 10th June, there had been prepared a coal cost study by the Canadian Pacific Railway and that coal cost study was the subject of this discussion, and I find that after introducing Dr. Edwards and qualifying him that I said at page 3323:

> "Now, Dr. Edwards, you have seen the Canadian Pacific cost study for the movement of coal from the mines in Alberta and Eastern British Columbia to Ontario?
>
> A. Yes, I have seen this document that has been circulated that gives the net result of this study and a summary and breakdown for various movements by individual items, and I had the benefit of two or three hours' discussion with the authors of the study, Mr. Brinks and Mr. Stone."

Mr. Brinks and Mr. Stone were at that time members of the Canadian Pacific's cost section, and we discussed the coal study study --

THE ACTING CHAIRMAN: Where is the study? Was it lost in the shuffle?

MR. FRAWLEY: No, the study itself is on

file with the Board. It was there that day for discussion purposes. We were referring to it by page number and by column number, and I find at page 3349(g) that this statement was made by myself --

MR. SINCLAIR: Just a minute, Mr. Frawley. Again, I do not know what this is. As I said, what my friend is proposing to do may be quite all right, but it is not a matter, surely -- if it is public then it is all right.

THE ACTING CHAIRMAN: If it is a public document it can be filed.

MR. SINCLAIR: Yes, but surely in a matter of this kind I can take a look at it.

MR. FRAWLEY: Yes.

MR. SINCLAIR: I am sure my friend would allow me to do that.

THE ACTING CHAIRMAN: You can speak to it.

MR. SINCLAIR: Yes, but, surely, it does not have to be handed in now. 1952 is a long time ago, and --

THE ACTING CHAIRMAN: Refresh your memory by reading the record.

MR. SINCLAIR: Thank you, sir. I do not have to read it now, do I, because I would like to hear the evidence?

THE ACTING CHAIRMAN: No.

MR. McDONALD: If it pleases the Commission the next witness will speak to the memorandum regarding the cost of capital which was circulated by the Canadian National Railways among counsel and

to the Commission, and the witness who will speak to this memorandum is Mr. J.L. Toole, vice-president of accounting and finance, Canadian National Railways. I will file a precis of his evidence as Exhibit 76, and the table attached to it as Exhibit 76-A.

---EXHIBIT NO. 76: Document entitled: Canadian National Railways; Memorandum regarding cost of capital.

---EXHIBIT NO. 76-A: Statement N.A.-1 Attached to Exhibit 76.

TOOLE, John L. Called:

DIRECT EXAMINATION BY MR. McDONALD:

MR. McDONALD: Mr. Toole was born in London, Ontario, in 1913. He obtained a B.A. degree in Commerce and Finance at the University of Toronto in 1936. He has been a certified public accountant since 1939. He is a member of the Certified Public Accountants' Association of Ontario, and also the Dominion Association. He was with Canadian Industries from 1939 to 1941 as Group Accountant; with the Dominion Rubber Company from 1941 as assistant controller, and in 1948 he ended up with them as Control Manager of the Mechanical Goods Division.

Mr. Toole joined the Ford Motor Company in 1949 as Assistant Controller where he remained until 1954. In that year he joined Canadian National Railways as Assistant Comptroller. In 1957 he was appointed comptroller, Canadian National Railways, and in 1959, Vice- President of Accounting and Finance.

Q. Does that correctly outline your history?

A. That is correct.

Q. By the way, Exhibit 76 was prepared by you, or under your supervision?

A. That is right.

Q. And it is correct? Will you just outline your evidence for us, please?

A. Canadian National agrees with the principles enunciated in the memorandum submitted

by Canadian Pacific Railway regarding cost of capital. Canadian National adopts the rate of 9.25 per cent as the cost of equity capital for the reasons outlined in the said Canadian Pacific memorandum.

The attached statement (N.A.-1) has been prepared to show the capital structure of the Canadian National Railways at December 31, 1958 and a calculation of interest and amortization charges thereon amounting to the composite rate of 6.95 per cent per annum.

The consolidated balance sheet at December 31, 1958 has been used as the basis for determining the principal amount of long term debt and shareholders' equity outstanding. The capital requirements of Trans-Canada Air Lines are provided by Canadian National Railways and the long term debt and shareholders' equity as shown on the attached schedule have been adjusted to reflect this special situation. As the $100,000,000 debenture issued to the Government of Canada under the Capital Revision Act, 1952 and the Canadian Government Railways working capital advances of $16,988,091 are non-interest bearing at the present time, the aggregate of these amounts has been transferred from debt capital to equity capital.

Interest and amortization of discount on the outstanding bonds, debentures and equipment obligations have been calculated on an annual basis and this results in an average cost of 3.458 per cent per annum. It has been calculated that if a bond issue had been sold to the public in

December 1958 to refund the $311.2 million loans from the Government of Canada, it would have cost the company an average rate of at least 5.10 per cent per annum, which is the rate you will find used in the schedule. The total of these two rates produces a combined annual rate of 3.841 per cent for debt capital. The rate of 9.25 per cent has been applied to the total of the shareholders' equity to produce a return of $167.0 million which, when added to the $51.2 million of interest on debt capital, produces a composite cost of capital employed of 6.95 per cent.

On this basis we conservatively used 6.5 per cent in the cost study.

MR. McDONALD: At this point, Mr. Chairman, I would like to file with you for your ready reference copies of the annual report of the Canadian National Railways for the year 1958. This will be Exhibit No. 77.

---EXHIBIT NO. 77: 1958 Annual Report of Canadian National Railways.

MR. McDONALD: That concludes the evidence-in-chief of Mr. Toole, and he will be available for cross-examination when the Commission resumes.

COMMISSIONER ANSCOMB: You borrowed $3 million a couple of weeks ago. Just how much did you pay for that?

THE WITNESS: That loan has two maturities in it. There is December 15, 1964 and convertible

up until June 15, 1964. The coupon rate is 5-1/2 per cent. It was a loan of $200 million, and the company's cost of it is 5.96 per cent.

The other $100 million will be issued as of January 1, 1960, maturity January 1, 1985, 5-3/4 per cent coupon.

COMMISSIONER ANSCOMB: Twenty-five years, a quarter of a century.

THE WITNESS: That is right -- 5-3/4 per cent, 5.93.

COMMISSIONER ANSCOMB: 5.93?

THE WITNESS: Yes.

THE ACTING CHAIRMAN: The effective rate?

THE WITNESS: Yes; just a shade under 6 per cent.

THE ACTING CHAIRMAN: I think we will adjourn now for five minutes.

---Recess.

THE ACTING CHAIRMAN: We have considered this matter of dates, and we have decided that we have to rule, and we are ruling that the Commission will meet in Ottawa on January 11th, but it will be in private session. We hope that during that week, on the 13th, 14th and 15th, the experts of Mr. Frawley and Mr. MacKimmie will get together with Mr. Cooper for the purposes of studying those questions that are involved there. Then, on the morning of the 18th in this room we will proceed with the cross-examination of witnesses, and with

the examination of Mr. McCoy and Mr. Roberts. I think that is clear now.

We will adjourn now until then.

---Whereupon the hearing adjourned at 4.00 to resume at 10.00 a.m. Monday, January 18th, 1960.

Thc ...

ROYAL COMMISSION

ON

TRANSPORTATION

HEARINGS

HELD AT

OTTAWA

VOLUME No.: 21

DATE: JAN 18 1960

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EXHIBITS

ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 18th day of January, 1960.

COMMISSION

Mr. M. A.	MacPherson, Q.C.	Chairman
Mr. H.	Anscomb	Member
Mr. A. H.	Balch	Member
Mr. R.	Gobeil	Member
Mr. H.	Mann	Member
Mr. A.	Platt	Member

COMMISSION COUNSEL

Mr. A. G. Cooper, Q.C.

Mr. G. S. Cumming

Mr. H. W. Ellicott - Adviser

Mr. F. W. Anderson	Secretary
Major N. Lafrance	Assistant Secretary

REVISIONS OF WITNESSES

VOLUME 21

Page	Line	
3014	7	Delete words "hasn't gotten"; insert "did not get"
3027	6	Delete word "increased"
	7	Delete whole line
3040	5	Delete word "Soo"

E R R A T A

3026	28	Delete word "length"; insert "revenue"
3027	5	Delete word "length"; insert "revenue"
	4	Delete word "length"; insert "revenue"
	21	Insert after word "any"; "explanation of"
3034	25	Insert prior to letter "Q"; "Mr. Frawley"
3035	17	Insert prior to letter "Q"; "Mr. Macdougall"
3040	4	Delete "fee"; insert "key"
	15	Delete word "difference"; insert "distance"

E R R A T A

Page	Line	
2986	8	Delete word "there"; substitute "then"
2987	5	Delete word "on"; substitute "in"
	18	Delete word "I" after think; substitute "you"
2988	10	Delete word "while"; substitute "well"
	12	Delete word "was"; substitute "us"
	15	"5.85" should read "5.95"
2991	17	Delete "follow"; substitute "below"
2997	4	Delete "reserves"; substitute "reverse"
	15	Delete "$70"; substitute "$17"
2998	8	Figures "6.56" should read "6.86"

REVISIONS OF WITNESSES

2987	6	Delete word "the"; substitute "a"
2991	14	Delete "it"; substitute "these"
2998	12	Delete "cost"; substitute "equipment trust"
3001	17	Delete "forms"; substitute "factors"
3002	7	Delete "get it to that extent"; substitute "sell and issue"
	14	Delete "wouldn't"; substitute "couldn't"

Ottawa, Ontario,
Monday,
January 18, 1960

---On commencing at 10.00 a.m.

THE CHAIRMAN: The Commission will come to order.

I think Mr. Sinclair has something to say.

MR. SINCLAIR: Yes, and possibly, Mr. Chairman and members of the Commission, before we do that I think, Mr. Frawley not being here, that possibly someone from the province might say something.

MR. MAURO: I think, Mr. Chairman and members of the Commission, before starting the work session again, that on behalf of counsel I want to extend to you, sir, our very sincere congratulations on your appointment as Chairman of this Commission. I also congratulate the Prime Minister in his continued good judgment in choosing you, sir, and I want to say on behalf of counsel who are appearing before this Commission that we are indeed pleased that the decision was made and we are satisfied that the work of the Commission will go forward and bring about some lasting solutions to these very serious problems. So I wish you continued good health and offer to you our complete assistance in the work of the Commission.

THE CHAIRMAN: Well, thank you very much, gentlemen. The circumstances under which the appointment has been made, of course, were a bit worrying, and I am glad to state to you that my information is that

[illegible]

Mr. McTague is doing very well, and we are hoping that he will continue to do so and be restored to health.

I want to thank my colleagues on the staff for the loyalty they have shown, and I can only state to Mr. Mauro -- and I think he is speaking for all of counsel -- that I appreciate the cooperation. We have a big job, and let's get on with it.

MR. SINCLAIR: Before asking Mr. Smith to return to the stand, Mr. Chairman, there were a few things that were in the record that we undertook to do, and I think possibly this is a good place to do them.

At Volume 12, page 1699, Mr. Frawley requested certain information having to do with in general increases which had been applied to the agreed charges. We have prepared certain statements, some of multiple pages, and clipped them together, and possibly that could be filed as an answer to Mr. Frawley's request, which I think was made to Mr. Edsforth, as Exhibit 78, which will be entitled: "Agreed Charges which were increased by negotiation as a result of general increases."

---EXHIBIT NO. 78: Certain statements entitled: "Agreed Charges which were increased by negotiation as a result of general increases."

MR. SINCLAIR: At Volume 13, pages 1797 and 1798, Mr. Brazier requested Mr. Edsforth if Canadian Pacific could develop figures which would indicate to what extent western Canadian grain moved to domestic markets in eastern Canada. Mr. Edsforth and his staff have considered this, and I am told by him, and I would

wish to give this answer to Mr. Brazier's question this way: "We have . . ." -- Mr. Edsforth speaking -- ". . . examined our records but have been unable to develop the information requested by Mr. Brazier, nor have we been able to find that it is available from any other source."

I should add that the correlation of figures of shipments to Fort William and expot shipments for a period to make them match those are not available, as far as we know.

At Volume 20, page 2825, Commissioner Mann asked Mr. Smith concerning loans guaranteed by the Government for the railroad industry in the United States arising out of the amendments to the Interstate Commerce Commission Act. We have found this information difficult to develop because these are not reported as financing in any of the normal ways, and, indeed, when you go to the Interstate Commerce Commission you find difficulty in ascertaining this information because of varying docket numbers and varying bureaus that are involved. We think we have them all, but we are not certain. But certainly we are convinced that we have the substance of them. There are five of railroad loans guaranteed under Part 5 of the Interstate Commerce Commission Act as follows:

Boston, Maine Railroad, $3 million 5 per cent notes, payable over fifteen years, $100,000 semi-annually guaranteed to the Bankers Trust Company as approved by the Interstate Commerce Commission, and that was issued in May, 1959.

[illegible]

Newhaven applied for two loans, one of $8.4 million and one of $1.5 million; both loans were for fifteen years. The ICC indicated that approval would be granted if favourable arrangements could be made, but deferred final disposition. The application for the loan of $1.5 million was later made at a rate of 5 per cent, September, 1959. The application for the loan of $8.4 million is on the basis that the loan was approved if placement could be arranged.

Now, apparently there was some difficulty concerning this, and, as far as we know, there has been some subsequent docket on it, but it was put to me that to trace this transaction through practically defies anyone. Any further information on that one, sir, you could possibly ask Mr. Smith or possibly you would be more successful in the tracing than we were.

Then the only large loan was the one to the New York Central of $40 million. This is serial maturities of 12 equal instalments, commencing in 1963. The rate is 5 per cent, which was specifically to reimburse the company for equipment expenditures made in 1957 and 1958, and also to assist in the financing of classification yard at Elkhart, Indiana.

The fourth one, Georgia-Florida Railroad, $1 million 5½ per cent notes, specifically for roadway maintenance and rehabilitation, approved in October. That company, as you may know, sir, is in bankruptcy.

Then the Lehigh Valley, $5.9 million, payable in instalments over 15 years, the notes maturing in 1960 to 1964 bear interest of 4½ per cent, 1965-69, 5 per cent, 1970-74 at 5-1/8 per cent. That was approved on November 17th, 1959.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

At Volume 20, page 2878, I was requested to secure information by the Chairman and supply it to Mr. Cooper concerning citations of a case that Mr. Smith dealt with. That has been done.

At Volume 12, 1639 and 1637, Mr. Mauro asked Mr. Edsforth to add certain material to Exhibit No. 49 concerning westbound commodity rates during the same periods. This information is being developed, and I will file it as soon as we have got it photographed.

Before I call Mr. Smith back, my friend Mr. Frawley wishes to put something before the Commission.

MR. FRAWLEY: There was a matter of cost data that we had requested from the railways, and it was -- well, a simple word is refused, and then we were told by Mr. Cooper that we should make a formal application to the Board and it could be returnable as early as this morning. I understood this wasn't a promise that it had to be brought on this morning, but it could be done as expeditiously as this morning. So, accepting that suggestion, we did draw a notice of motion and we had copies delivered to our friends, railway counsel and other counsel, and that motion is returnable this morning, and about ten o'clock these were supplied to Mr. Anderson. I am only rising at the moment to ask that the motion be stood over until two o'clock, and I would like to speak to it again at two o'clock.

THE CHAIRMAN: That is quite all right.

MR. SINCLAIR: Mr. Smith.

THE CHAIRMAN: I think we appreciate the fact that you have given us all the information, but it has meant a lot of work,we realize; we appreciate it.

MR. SINCLAIR: Mr. Smith, please. Mr. Smith gave evidence in chief to the Commission on December the 17th, and that evidence is in Volume 20 commencing at page 2802. He is returning here today to answer the questions of my friends and such other information as the Commission may wish to secure from him.

SMITH, Charles W., Resumed

CROSS-EXAMINATION BY MR. COOPER:

Q. Mr. Smith, I intend to refer to various pages of Volume 20 of the transcript of evidence and ask you, for the benefit of the Commission, to clarify in certain cases for their information and perhaps in other cases to enlarge upon what you have said in your direct evidence, and I direct your attention first to page 2806 of the transcript, and you will find at the bottom of that page an answer by yourself to a question put by my friend Mr. Sinclair:

"A. Public utility regulatory commissions in general make extensive use of what are known as 'cost of capital' studies. These studies are usually divided into three main parts, debt capital, preferred stock capital and common or ordinary stock equity capital, with a summary schedule showing the cost to the particular company under review"

Q. Now, I direct your attention specifically, Mr. Smith, to the word "usually", and I would like you to tell the Commission whether there are other methods of conducting these capital cost studies other

[illegible]

[illegible]

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than dividing the studies into three main parts such as you have done.

A. As to the cost studies themselves, the answer is no. They are invariably divided in the manner which I have explained. In some cases, other studies -- studies other than capital cost studies -- are employed. For instance, you will find sometimes some authorities in this field try to measure the risk factor by some objective test other than cost of capital. But every witness I have known of in recent years in cases of this kind have put cost of capital studies divided in the three categories I have mentioned.

Q. I understand, Mr. Smith, then, that if one is doing cost of capital study one invariably, in your experience, deals with debt capital, preferred stock capital, and common or ordinary stock equity capital?

A. Yes, sir, that is correct.

Q. Now, on page 2807, in answer also to a question by my friend, Mr. Sinclair, you stated that the cost of debt and preference stock capital is developed by studying the cost over a period, but that in the second case you use the cost of debt and preferred stock capital as the current cost of 1958.

Now, am I to understand that ordinarily in such a study you would not take current costs in any one year but would take cost over, say, a number of years?

A. No. I had better enlarge upon that.

The studies as to debt and preferred stock capital in general cover a period of years. The study as to the particular company may include a period of years, but there is always one study as of some date immediately in the past or some date estimated some distance in the future -- say, six months or a year in the future.

Let me tell you one of the reasons we do that. First of all, we try to study a trend to see what we may experience in the future. And, secondly, we also study these other issues of debt and preferred stock securities over a period to determine whether any of the company's existing debt cost too much.

I have in mind one case where the Federal Power Commission said that the company's debt securities involved a rate of more than ten per cent and the debt securities were refundable and said we will allow three per cent because in our opinion three per cent is reasonable.

Q. Do you know, Mr. Smith, whether these cost of capital studies are carried out in this same way in Canada? I think your evidence related to the United States, if not entirely to the United States.

A. I know some of them are carried out this way. I have seen studies. In the Bell Telephone cases, I have seen several studies which were presented to the provinces. They were all generally within this framework. Some of them

went beyond this framework -- went in a direction I would not go. Some of them substitute current costs for what we normally term historial or imbedded costs. Some witnesses with whom I do not agree -- with whom I disagree -- would today substitute six per cent, say, for debt security cost instead of the low debt security cost which is reflected for Canadian Pacific in my exhibit.

My point is to the extent they make a real cost of capital study, I think they do pretty much what I have done here.

I must constantly point out that judgment is involved. Their judgment may not be the same as mine, particularly when it comes to the common equity factor.

Q. When you come to the common stock equity factor, then it is a matter pretty well of judgment?

A. It has involved judgment after studying a lot of objective facts.

Q. Also at page 2807 you use the phrase, Mr. Smith, that "to protect the financial integrity of the enterprise". I wonder if you would just enlarge on that phrase for a moment to explain it for the benefit of myself and the Commission?

A. Protecting financial integrity means that you protect the investment which has been made in the company in the past to keep that from being impaired so that it will get reasonable compensation.

Now, the test of that, or some of the

tests I have made here -- and, in addition, there is another test I didn't speak of -- when it comes to debt securities or when times interest is earned, so-called coverage is a factor because, if you have investment equity debt securities, if you do not earn your interest a certain number of times, the debt securities will then have a lower rating and that will impair the equity and will impair the investment which is made in them. That is not present here -- that's the reason I didn't talk about it -- but that is generally what we mean by impairing the investment.

Q. I am not entirely clear, Mr. Smith, as to the use which is made of cost of capital studies by regulatory commissions, by which I think you mean public utility commissions in their rate-making functions.

A. Well, I perhaps can explain that more in detail.

Practically every Commission I know of makes cost studies -- cost of capital studies. I do not know of an exception right now that does not have studies made or have its staff make them respecting debt securities and preferred stock.

A couple of years ago, the Public Utilities Section of the American Bar Association, reporting on this subject, stated that Commissions in the United States continued to emphasize the cost of capital concept in rate of return decision.

Now, the Federal Power Commission goes a

little further in this than other Commissions, although, as you know, the Federal Power Commission is cited as an authority. It is imitated rather extensively. The Federal Power Commission very frequently in its decision says, this return will allow the payment of interest which equates to a certain rate; the payment of preferred stock dividends equates to a certain rate, and, in the case of Northern Natural Gas Company, $9\frac{1}{4}$ per cent for the common equity. It spells it out in that detail.

Other Commissions are doing the same thing, but I could not speak for all the Commissions in the United States because some of their practices are different. But it represents, I would say, generally minor departures and approach the problem at a different angle.

Q. That is one of the factors of rate-making, as far as it goes?

A. Yes, I think that is thoroughly established.

Q. When you refer to Public Utility Commissions -- perhaps you have already touched on this before this morning, Mr. Smith -- do you include such Commissions in Canada?

A. No, I was speaking of regulatory commissions in the United States. My knowledge of Commissions in Canada is rather limited. I do have some knowledge of the work of the Board of Transport Commissioners, but I would not like to

go beyond that.

Q. I turn, Mr. Smith, to chart 1 of Exhibit No. 75. That is the chart which is headed "Yields on United States Treasury Bonds -- long term issues, 1950 to date".

You comment on this chart in your evidence, and it extends to September, 1959. Now, would you care to express an opinion, Mr. Smith, as to the trend of yields of United States Treasury Bonds, say, for the next five years?

A. No, sir, I would not say what they are going to be in the next five years. I think any man that does that would be insane.

Q. I take it that that answer would also apply to any questions with respect to yield trends on railroad bonds?

A. Yes -- five years, it certainly would.

Now, if you say for the next year, I can say I can see nothing in the picture that will change our situation drastically in the next year, but I would not speak for five years because so many things could happen in that time.

Q. With respect to this one year period, are you directing remarks also to United States Treasury Bonds as well as railroad bonds?

A. Yes, that is correct. I do not know of anyone today who would indicate or state that we are going to have a drastically changed picture in 1960. We know we still have inflation -- that is,

we know we still have the policy of Government that is to try to put brakes on inflation through monetary control. We know the President has recently stated that his number one project is to lift the ceiling on Government interest rates of $4\frac{1}{4}$ per cent. We know that since the steel strike was settled, expansion is resuming; employment is higher than it has ever been, and every indication is that for the next year there are going to be good demands for capital, so that a lowering of interest rates would not likely occur. That is rising, of course, because I cannot tell the future.

Q. At page 2801 you state that the bonds included in the first series on chart 1 of exhibit 75 were due or callable in eight years.

Now, I notice that on schedule 1 of exhibit 75 the text underneath the figures there appears to indicate that these bonds of the first series were due or callable in some instances in longer periods than eight years, or am I misunderstanding the text under the figures in schedule 1?

A. I think you are correct, Mr. Cooper, and the text controls.

(Page 2912 follows)

Q. The text of Schedule 1 of Exhibit 75?

A. Yes, that is correct. I worked this text out many years ago by going to the Treasury Department, and I must say that, in the case of any conflict between my own testimony and the text, the text controls.

Q. I think there is a slight inconsistency. At page 2810 you state:

". . . The bonds included in this first series were due or callable in eight years. . ."

Whereas the text says that yields from October 1925 to February 1943 are based on bonds due or callable after twelve years, and then it refers, further, to April 1944, when the series was revised, beginning February 1943, to include all outstanding partially tax exempt issues due or callable . . .

A. Yes; I think I read the first sentence and stopped there when I gave my testimony, because the first sentence says for the period 1920 to 1945 the issues of all outstanding partially tax exempt government bonds, due or callable . . . I probably didn't read far enough.

Q. Well, I thought I might clear that up, in any event, for the benefit of the Commission.

A. Thank you.

Q. Will you turn to Schedule 2 of Exhibit 75 and just explain, if you will, the footnote "Theoretical yields 15-year bonds"?

A. I can't explain it except that I believe it is the yield at maturity. In other words, if you held the bonds to maturity that is what you would get.

[illegible]

It is not actual, current yield. A lot of these bonds are purchased at discount and the current yield is much lower than the yield at maturity, when you would get the difference between the discount price and the par value.

The statement was taken from a publication concerning Canadian bonds.

Q. The U.S. Treasury yields given there are presumably not on the same basis?

A. They are on the maturity basis also. I think they are on the same basis. But in the one case the yield is at maturity, and in the other case they are called "theoretical".

Q. But you still say they are on the same basis?

A. That is correct.

Q. I refer you to page 2818 of the transcript. You refer there to the collateral trust bonds of Canadian Pacific as being rated Ba by Moody's. Do you know the yield from these bonds, say, for the year 1957?

A. No, I don't have that figure.

Q. And 1958 you have not either?

A. No.

MR. SINCLAIR: We have it in our papers. We can supply that. It is 1957 and 1958?

MR. COOPER: 1957 and 1958.

Q. On that page you state that ". . . The Ba ratings on yields are not usually shown because the Baa, generally speaking, is the lowest rating which

qualifies for investment by banks . . ." I take it, of course, those are banks in the United States?

A. That is correct, sir.

Q. Are any bonds of Canadian companies qualified for investment by banks in the United States?

A. I do not know. I am sure banks have such bonds, but I don't know they would qualify for your banks' standards when they analyse the financial statements.

The statement that Baa was the lowest for investment by banks came, generally speaking, from the rating agencies -- standard and poor in Moody's.

Q. If no Canadian bonds are included in any class above Ba as a matter of rating, then, it would be impossible for Canadian Pacific, no matter how good a bond, to get above a Ba rating?

A. I don't think that is true, but I will say that I think you could put Canadian Pacific bonds on the rating Baa, due to the fact that they are Canadian bonds.

Q. On page 2823 you state that most of the debt financing of railroads in recent years has been through equipment obligations?

Now, for the benefit of those who don't fully understand these things -- which includes myself -- would you explain the methods of railroad financing, briefly?

A. This method is really buying equipment on the instalment plan.

There are, basically, two methods. One is the conditional sale method, and the other is the

Philadelphian plan, but they have the same purpose.

The equipment obligations are issued against locomotives, cars, rolling stock and the title is held in trust, or held under a conditional sale contract. If payments are not made -- and payments are usually made serially in fifteen years -- the equipment can be taken back by the seller.

Q. Title to the equipment remains in the seller?

A. In the Philadelphian plan, it remains in the trustee who acts for those who own the equipment obligations.

During the depression I believe there was one issue of equipment which failed. It is considered high-grade security. Naturally, it would be, because the railroad would be worthless without its rolling stock.

Q. When you make reference later on to equipment trust certificates you are referring to equipment obligations where the title to the actual property is held by the trustee?

A. That is correct. As a matter of practice, the railroad puts the equipment on its books at cost, and puts the equipment in as a liability, which it is, substantially.

The legal form, however, is somewhat different from that.

Q. On page 2824 you refer to five issues of bonds in 1958. Were those issues refunding issues or new financing, Mr. Smith?

A. These were, I believe, new financing.

Q. They were all new financing?

A. They were. They were in part at least, I feel reasonably sure.

Q. At page 2827 you refer to issues of Canadian Pacific collateral trust bonds at 5 per cent, and they sold at a yield of 5.14 per cent. I take it those bonds are included in Schedule 15 under the entry of "Collateral Cost Bonds, $125,969,177" ---

MR. SINCLAIR: Line 9.

THE WITNESS: Yes, that is correct.

Mr. Cooper, may I go back for a moment on your question as to rating, to supply another additional fact?

Q. Yes, certainly.

A. Where a company has a first mortgage bond outstanding and has this other type of security such as a collateral bond or a debenture, normally the other type is regarded one grade below the first mortgage bond, and that is automatic.

Q. So if you have got a collateral trust bond it is automatically rated below the first mortgage bond?

A. That is so. I am sure in the case of debentures I could mention companies which have bonds outstanding and debentures. The debentures are issued and they sell on the market. The bonds are rated aaa and the debentures as aa. If you have only debentures outstanding, such as Consolidated Natural Gas Company, you can get aaa rating for these debentures; but they have to have the first claim.

Q. In other words, the debentures are regarded, in a company which has a first mortgage bond outstanding, as what one might call junior security?

A. That is correct.

Q. But if the debenture is the only issue they have outstanding they get the rating of senior?

A. Yes.

Q. Do you know, by the way, Mr. Smith, what the security is for those collateral trust bonds to which you have referred at page 2827?

MR. SINCLAIR: That is quite a legal question. I don't know if you know that. And while Mr. Smith is a lawyer, I just rise to say that that is a legal question.

MR. COOPER: Well, I don't know that a question as to what security is behind the bonds is actually such a question, as Mr. Sinclair says. However, perhaps I can drop that question, and any information I want on it I am sure I can get from my friend Mr. Sinclair.

MR. SINCLAIR: So long as I am not going to give an opinion.

MR. COOPER: Oh, no -- and I am sure I am not casting any reflection on your opinion.

Q. At page 2830 you give cost equipment issues of Canadian Pacific in 1953,1954 and 1958. Can you compare the cost of these issues with some of those on Canadian Government bonds during the same period?

A. I think we might do that by going to Schedule 2. Schedule 2 is on a yearly basis whereas page 2930 identifies the date of issue by particular

months. But I think you can make a rough comparison that way.

Q. They can pretty well be checked up. For example, in 1953, Government of Canada 3.68, and equipment issues dated to 1963 cost 4 per cent?

A. Yes.

Q. And the comparison would be a valid comparison -- that is, Schedule 2 as against the equipment rates given on page 2830?

A. Yes. I would like to call to your attention that the issues of 1954 involved some other costs than the issues in 1953, and the Government of Canada bonds went down that way.

Q. On page 2850 you give Canadian Pacific stock yields for the year 1956 to 1959, based on quotations on the Montreal Stock Exchange, and these are higher than the yields for the same series shown on Schedule 9. Perhaps you could just explain the difference there, Mr. Smith?

A. I expect that the difference is due to the exchange rate, primarily.

Q. I thought it might be the exchange rate in that exhibit.

A. I think so.

Q. Now, turning to Schedules 13 and 15, on Schedule 13 is shown ordinary stock and retained income totalling $730,571,549. Now, on Schedule 15 ordinary stock and retained earnings is shown as $840,107,330.

Perhaps I am missing something -- and undoubtedly I am -- but I can't quite understand the difference

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between these two figures -- why there should be that difference.

A. I can straighten it out. We are not comparing the same figures with the 730,000.

Q. It is $730,000,000?

A. Yes, $730,000,000; it doesn't include the premium and discount on capital stock and doesn't include donations allowed by the Board of $35,000,000. You see, the $730,000,000 consists of ordinary stock and retained income. Now, on schedule 15 I have included in ordinary stock and retained earnings those other items.

Q. The other items are what?

A. Well, premium on stock is one of the items.

Q. Yes. Is that the figure of $41,539,469, according to the schedule?

A. This is premium on ordinary stock, it is $78,297,354. On the balance sheet, schedule 13, if you figure $41,539,469, it is a combination of discount on debenture stock and premiums on capital stock.

Now, on schedule 15 I have transferred the discounts on debenture stock to debentures in order to get the actual cost of debenture capital. I think we could prepare a complete reconcilation of this figure, and I will be glad to have it prepared and submitted.

Q. I would appreciate it very much, Mr. Smith, if you could have such a reconcilation prepared and filed.

Also on schedule 13, preference stock, 4 per cent non-cumulative, $137,256,921, as against on schedule 15, $121,375,308.

A. The $121,000,000 figure represents actual proceeds on the issuance, instead of the principal amount, the par value, shown as a liability in the books.

MR.SINCLAIR: Just on schedule 13?

THE WITNESS: Just on schedule 13. In determining the costs of capital, we use the actual proceeds instead of the par value.

MR. COOPER Q: The actual amount which the company received for the sale of its preference shares.

A. That is right.

Q. Would you just explain also for my benefit on schedule 15, leased lines securities, not owned.

A. That represents securities on lines which are leased and on which Canadian Pacific has the responsibility to pay the charges.

Q. What is Canadian Pacific's responsibility there, is it a contingent liability or direct liability, or what?

A. I think I had better ask Mr. Sinclair to help me on that one.

MR. COOPER: Well, perhaps we can get Mr. Sinclair's decision on that.

MR. SINCLAIR: They are pursuant to lease in many cases with statutory approval; for instance, the Quebec Central requires a specific payment on the ordinary stock.

THE CHAIRMAN: Well, they vary.

MR. SINCLAIR: Yes.

THE CHAIRMAN: Very greatly.

MR. COOPER Q: Are they direct liabilities or contingent security?

A. They are direct in the sense they must be paid by the company, and Canadian Pacific pays them directly to stock or bond holders of the leased lines.

Q. Have you taken into account at all in your study here, Mr. Smith, any provisions of the Canadian Income Tax Act giving relief with respect to dividends paid to individuals holding stock in Canadian companies?

A. I have taken it into consideration to the extent that it is reflected in the market price of the stock. In other words, I think our best objective test is to go to the market place where we get the money, and to the extent that it is reflected in the price, I have taken it into consideration.

Q. Actually, insofar as the market price is concerned, you have not given any independent consideration to that 20 per cent income tax rate?

A. No, I haven't made any subjective tests of that kind; if I did, I would be here a long time. I think the market place itself is by far the best.

MR. COOPER: Thank you, Mr. Smith. That is all, Mr. Chairman, I would like to ask this witness.

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THE CHAIRMAN: Mr. Frawley?

MR. FRAWLEY: Some of my friends have some cross-examination.

CROSS-EXAMINATION BY MR. MAURO:

Q. Mr. Smith, I just have one or two questions, sir. On page 14 of your precis the last paragraph, you say:

"In Schedule 10 I compare earnings-price ratios, yields and pay-outs of industrials, utilities and railroads. The figures are computed from data published by Moody's for each series. The significant conclusion I draw from the study is that railroads had higher earnings-price ratios and higher yields than the other two groups. This is strong evidence of the greater risk inherent in railroad equities, for which higher compensation is required in order to protect the integrity of railroad equities and thus enable the industry to attract equity capital on reasonable terms."

Mr. Smith, the Canadian Pacific Railway is somewhat unique as a corporation, and I wonder if there is a corporation in the United States at all similar to the Canadian Pacific Railway, having in mind ~~the~~ capacity and operation of the Canadian Pacific Railway in the field of transporation, not only by rail, but by road, water and air, and its other holdings in gas and oil, etcetra?

A. I think it is a question of degree, but

I know of no railroad in the United States which is engaged in the transportation business as extensively as Canadian Pacific. Some of them do have other operations; the Santa Fe has some oil properties, and so forth, and others do have other operations which are income producing.

Some of the incomes of some of the American railroads are quite substantial, but they are not comparable to the Canadian Pacific in that Canadian Pacific is engaged in transportation in a broader fashion than any United States railroad that I know anything about.

Q. As a matter of fact, I have been advised that Canadian Pacific is probably unique on the continent in having this capacity and this broad potential of being permitted to enter into transportation in every aspect.

A. Well, I am worried about your word "potential"; I will admit the fact that they are engaged in the transportation industry very broadly, but the word "potential" involves some anticipation in the future.

Q. I will put it this way; I understand at this moment, Mr. Smith, that a General Doyle is conducting an inquiry in the United States, one of the subjects of which is whether or not railroads in the United States should be permitted to enter into trucking.

A. That is right, and there are a great many people who feel the railraods should be engaged

in that, but my point was about the word "potential", whether railroads engaged in the air business would be much better off or worse off; I think it is a question in the United States which would be subject to debate.

Q. If one can use the term "integrated" with reference to a transportation company, it would be rather a comforting feeling to a stockholder to know that the corporation could enter into it in possibly a competitive range, depending on the demands of the market.

A. It would depend upon the profit alternatives in that field. I would say that there would be some benefit in knowing that the company can engage in what would normally be a competitive enterprise. The others, if not competing with yourself, doesn't help you out very much; it would depend upon the opportunities for profit in these other fields.

Q. If there is to be any growth in transportation as such, I suggest, Mr. Smith, that the Canadian Pacific Railway is in an excellent position to grow with this growth?

A. Well, I am one who believes that there is going to be growth in railroad transportation, and I still think that the inter-city transportation in a big way will have to be carried on by the railroads, as far as I can see in the future.

I expect them to grow; it is estimated that in 1960 the railroads in the United States will develop $1,400,000,000. in capital improvements, and

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that is a larger sum than they have spent for several years.

Q. In addition to this anticipation of the growth of railroad transportation, you would then further agree that in transportation by truck or transportation by water or transportation by air, any potential growth in these fields of transportation are also open to the Canadian Pacific Railway?

A. Well, I understand so, but I don't believe they have a blank cheque with regard to air transportation.

Q. No, I think the cheque has certain limitations on it now.

I would then suggest, Mr. Smith, that the Canadian Pacific Railway has, in fact, a very excellent growth potential in the entire field of transportation?

A. I like to think so. When I testified before the Board of Transport Commissioners in 1952 I reached a lower conclusion as to the rate of return than was justified by the facts, under the very scheme you are now expressing. Unfortunately, that has not happened up to this time, but I still hope it will come about.

Q. But you have personal hopes, as you mentioned before, for transportation generally, and ultimately for a revitalization of transportation?

A. We have to have transportation if we are going ahead economically, and I don't see anything to take the place of railroads as far as I can forsee in the future, and if railroads get fair earnings over

a period of time, they might take their place with the electric and gas utilities, but they have got to have these earnings for a time to demonstrate their confidence and in order to get capital from investors, under what we call good terms and conditions.

Q. At page 17 of your precis, Mr. Smith, you were referring to your study of the ordinary stock; you were referring to the ordinary stock equity which is allocated to rail enterprises, and I wondered if you made a study of the per share value of the rail enterprise in the market price of Canadian Pacific Railway stock?

A. The market price today is about $25 a share, approximately.

(Page 2932 follows)

Q. What would you say if the $25 was made up of rail enterprise?

A. Well, it is difficult to say. I have got to pierce the minds of investors and see what weight they give to the other income. We do know that the stock does fluctuate as other income goes up and down. But it is pretty hard to say that the investor has a particular dollar and cent figure in mind at a particular time.

Q. You have never seen any statements put out by reputable stock houses on a study of the C.P.R. wherein they evaluated the other asset portion of the market price?

A. Yes, indeed, I have seen such statements; I have seen statements to the effect that of the earnings on the stock 50 cents come from this source or 40 cents come from this source. But you asked me how much was in the market value of those things. I think the investor looks at the entire picture when he makes an investment. You cannot very well break it down by segments.

Q. At page 18, Mr. Smith, the first complete paragraph, you say:

> "It is my conclusion that the dividend on the equity should be approximately 6 per cent."

How does this compare with the dividend factor in the permissible level of earnings as established by the Board of Transport Commissioners?

A. The last Order I read of the Board of Transport Commissioners approved rates which were to yield

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six per cent. I think the rate was five per cent on part of the total equity as I compute it.

Q. Could you tell us what six per cent would mean in dollars?

A. Well, it would mean six per cent on the figure I show in Schedule 15, namely, six per cent on $847,107,330.

Q. I am not good at mathematics at all, Mr. Smith; I was just wondering if you could ---

A. Approximately $50 million.

Q. I have here a Judgment and Order of the Board of Transport Commissioners dated November 17, 1958, and I am reading from Exhibit No. 58(30), and I notice under a heading "Requirements on Board's basis, dividends, 1959, $20,661,000." So the difference between what you feel would be a proper dividend return on equity stock and that of the Board's would be somewhere in the neighbourhood of $30 million?

A. If I accept your figure of $20 million; but I should say that unless a railroad gets that it is not going to take its place with other business enterprises in Canada and the United States.

Q. I am very sympathetic to your approach, Mr. Smith, in the sense that I am satisfied you are making a different approach from the Board of Transport Commissioners, and I am just trying to get it into its proper text.

THE CHAIRMAN: May we take a short recess now?

---Short recess.

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MR. MAURO: Q. Mr. Smith, I would refer you to Schedule 14 of your precis entitled: "Rail Enterprise net investment, December 31st, 1958," and I note that you have calculated this net rail investment to be $1,440,149,678. Pursuing your approach as to proper return, I take it you would suggest that the Canadian Pacific Railway received 6.5 per cent on its net rail investment?

A. Essentially that is correct, but for the purpose of this case I have expressed it differently. It ought to get the compensation for the capital that is represented by that net investment with capital broken down between debt securities, preference stock and ordinary stock equity. It comes to the same thing in the end.

Q. I have calculated this figure out. 6.5 per cent on the net railway investment would return to the C.P.R. $93,609,729, and with reference to the Board of Transport Commissioners' Judgment and Order dated November 17th, 1958, I see that they have calculated as the permissive level of earnings for Canadian Pacific, 1959, at $55,225,000. Under your proposed plan that would mean a difference to the Canadian Pacific Railway of somewhere in the neighbourhood of $39 million?

A. From the figures you have given, that is correct. Do you want me to comment on it or stop there?

Q. My final question is: There is little doubt that what you are suggesting is that the present requirements formula be suspended and that we introduce a rate base rate of return?

A. That is not so. I don't care how it is worked out. I would say that the capital of this country and the United States will erode away unless it is integrated and protected, and if it is not protected you are not going to get new capital to do the jobs that ought to be done unless you pay the going rate for money. It is as simple as this to me.

Q. But in your opinion the Board of Transport Commissioners should adjust their permissive rate of earnings from 55 million to 93 million?

A. We are talking about different times, of course, but in general what you say is correct.

THE CHAIRMAN: Before you go on, Mr. Dickson -- Mr. Smith, you indicated that in your opinion the expenditures by the United States railways was 1.4 billion?

A. Yes.

Q. Where will they get that money?

A. That is a big problem, to the extent that they are going to purchase equipment when they can issue equipment obligations. Unless we have a firmer tone in their railway market securities they are going to have a hard time in getting money for equipment and improvement and building marshalling yards and things of that kind. There has been some improvement in the building of railroads since the Transport Act of 1958. I am sure some railroads can issue debt securities; C.N.O. can issue more bonds, but some of them will have to get more loans to continue.

Q. Guaranteed by whom?

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

A. By the Government of the United States, and that would be as a last resort. None of us, railroads or others, financial people, like this business of the government guaranteeing railroad loans. A lot of restrictions are tied around it. If you read the orders of the ICC you will find that they approve a loan and make the guarantee only if they think there are prospects of repayment, otherwise it is not made. It is not a gift or a risk being transferred to the government; it is only where they find that there is a good chance of getting the money back is the loan guaranteed.

THE CHAIRMAN: And this money that you think will be spent by the railroads in capital expenditure they will have to get from the public?

A. Most of it from the public, but some of it may be guaranteed. Some may be guaranteed by the government. That comes from the government, but there is also a guarantee at the back of it. The government doesn't put up the money, but it guarantees a loan. Railroads have not been too receptive to that sort of thing; they would much rather finance on their own when they can do so. As a matter of fact, the guarantee by the government has not resulted in getting real low interest rates as some people have hoped for.

Q. It has not lowered the rate?

A. I don't think so. The New York, New Haven and Hartford borrowed this loan which I could not trace which was authorized some time ago by the ICC. They borrowed $503,000 in January of this year and they

A. [illegible]

that [illegible]

[illegible]

[illegible]

[illegible]

that the [illegible]

[illegible]

[illegible]

case, [illegible]

to the government [illegible]

there is a [illegible]

the [illegible]

The [illegible]

will be [illegible]

they will [illegible]

A. [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q. [illegible]

A. I [illegible]

[illegible]

[illegible]

[illegible]

paid 5½ per cent for the money. Now, you had a couple of equipment issues at about 5.20 per cent in relatively the same period of time by other railroads, and I don't think it has had a material effect on the interest rates. Some railroads were hoping to get cheaper money by the government guarantee. We do not have much cause for rejoicing in that particular matter.

COMMISSIONER ANSCOMB: Is there any possibility of a percentage of the $1.4 billion which will go to equipment money? In other words,how much will be left?

THE WITNESS: The story was issued by the American Association of Railroads. There is some checking of the Wall Street Journal. It is going to be about $1 billion in equipment.

COMMISSIONER ANSCOMB: You would have $400 million to be borrowed from somebody for keeping her afloat?

THE WITNESS: Yes.

COMMISSIONER MANN: The $1 billion for equipment -- this is strictly for rolling stock and motive power?

THE WITNESS: Yes.

COMMISSIONER MANN: What is involved in that? Yards and so on?

THE WITNESS: No.

COMMISSIONER MANN: Are the yards in there?

THE WITNESS: Well, the $400 million takes care of the yards, but it is chiefly equipment items.

COMMISSIONER MANN: Rolling stock and motive power?

THE WITNESS: Yes; the equipment you can take from one railroad and put on another. That is the reason they were the most attractive of their day in all public instruments of finance.

COMMISSIONER MANN: That $1.4 billion includes some of the money that is covered by some of the guaranteed loans referred to by Mr. Sinclair earlier?

THE WITNESS: I think there would be some of that money involved. Strange enough, some of the guarantees so far have been for equipment security obligations.

COMMISSIONER MANN: I was just doing some totalling here. If all these loans were approved by the Interstate Commerce Commission, I think the total is in the order of $68 million out of the $1.4 billion. Would that be a correct way of putting it?

THE WITNESS: That is correct, and that is through 1959. Now, the large loan to New York Central was in connection with equipment to a large extent.

COMMISSIONER MANN: I had a note here that this was for the Union Barge Line. Is that correct?

THE WITNESS: No, sir, that is not correct.

MR. SINCLAIR: That was the only large one; that was the N.Y.C.

COMMISSIONER MANN: It wasn't the Union Barge?

MR. SINCLAIR: No. It was 5 per cent notes due in twelve equal instalments, starting in 1963, and it was to reimburse the company for equipment expenditures in 1957 and 1958, and a proposed classification yard at Elkhart, Indiana. That was specified in the basis of the loan and with the guarantees, and I haven't got the

placement on that one.

THE CHAIRMAN: But that takes in the yard?

MR. SINCLAIR: Yes.

THE CHAIRMAN: All right, Mr. Dickson.

MR. DICKSON: Thank you, Mr. Chairman.

CROSS-EXAMINATION BY MR. DICKSON:

Q. Mr. Smith, in answer to a question of my friend Mr. Cooper I think he was asking you to reconcile certain figures, and you indicated that the difference may lie in the exchange rate. For clarification, would you indicate what you mean by the exchange rate? Is that between Canada and the United States?

A. Yes, that is right; the Canadian dollar is worth more in United States funds.

Q. And is the dollar here Canadian dollars?

A. I have put it as being on the New York Exchange, which is American dollars, or on the Montreal Exchange, which is Canadian dollars.

Q. So when you give figures of the New York Exchange, those figures are in United States dollars?

A. Yes, that is correct; they are on the New York Exchange.

Q. At what rate of exchange?

A. I don't know. That is taken into consideration by the investor when he buys stock. In Canada today when an investor buys stock he is paid in Canadian dollars, and he gets more than in United States funds. I think that is the main explanation for the difference in price. I feel sure that the

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

exchanges are so close that if the dollar was worth par in both countries your quotations would be very close together. There will be some time lag, but I think they would be very close together.

Q. The difference is recognized in the exchange rate?

A. Yes. I pointed out in my Schedule 15 the tremendous effect that exchange hason the cost of preference stock capital.

Q. Mr. Smith, in your precis, Exhibit 75, you indicated that this study of yours has been prepared for the purpose of studying cost of money in the cost of moving grain and grain products?

A. Yes.

Q. And that factor has a substantial effect in determining that cost?

A. The cost of money?

Q. Yes.

A. Yes, it is a very important factor.

Q. Have you translated into dollars the effect of one per cent in that exchange rate? In other words, how much does an extra one per cent in that 6½ ---

A. One per cent would probably be about $14 million over all for the Canadian Pacific Railway enterprise.

Q. Have you applied it to the Cost Study which the railways have prepared?

A. No. You see, there are two problems in this rate study. I am determining the percentage cost

[illegible]

[illegible]

Q. [illegible]

A. [illegible]

Q. [illegible]

A. [illegible]

Q. [illegible]

A. [illegible]

Q. [illegible]

A. [illegible]

Q. [illegible]

A. [illegible]

Q. [illegible]

A. [illegible]

of capital; that is my job. The second job is the allocation, and how much of those dollars you allocate to one phase or another is another problem entirely. The same rate should be employed in allocating cost to another business. In the case of electric businesses where you have the off-peak, and so forth, you use the same rate, but your allocation is to a particular phase and depends on the kind of use and things like that, and that is a job I cannot do, I am not qualified.

Q. On both railways or just on the C.P.R.?

A. Just on the C.P.R.

Q. So for every increase in percentage by one you increase the cost in that line by $14 million?

A. That is correct. Every time the cost of money goes up in the market place we have to pay for it; governments are paying for it, everybody is paying for it.

Q. And, similarly, the cost goes up to the product, grain?

A. How much it goes up to the product depends on your allocation, and I am not holding as an expert in railroad allocation.

Q. You don't make any specific allowance for the bank rate?

A. The main reason for that is borrowing from a bank is on a short-term basis. We normally take only the long-term debt, because the capital has to be associated with capital that has a long life. There are cases when we do take it into consideration in this way. An electric utility company will build a hydro plant costing several hundred million dollars. It will

borrow from the bank on a short-debt basis, and when it gets to the debt of $25 million it will make a bond issue of $50 million and then go to the banks again. That is almost standard procedure. In some cases we will transfer from short-term borrowing to long-term. But borrowing today costs so much.

Q. Do you know whether the C.P.R. are entitled to the prime rate on their bank borrowings?

A. I would presume so, but I don't know. I know in the United States the prime rate is 5 per cent, but with a big catch in it. Because of the restrictions of the Federal Reserve Bank today, when you borrow large sums from the New York banks today you are required to keep 20 per cent on deposit, so the 5 per cent becomes 6 per cent.

Q. You don't know what the prime rate was?

A. No, I do not know.

Q. Now, in your precis, page 2, Mr. Smith, you speak of the current cost of servicing capital. By "current" are you speaking of the present or are you speaking of last December?

A. No, I am speaking of the time I made this study. That was the actual cost to the company at that time.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q. When was that?

A. That was generally last December, except I did bring the equity studies down to date. I did not anticipate any additional bond financing or things of that kind, but I did include some consideration of equity capital down to the time I testified.

Q. Well, you made up this study last December -- a year ago?

A. No, I made up this study last fall.

Q. What month?

A. Well, I started sometime -- either September or October, I believe.

I would like to make this statement to you: that in 1958 I made a study for Canadian Pacific and I was asked to bring that study up-to-date last fall. That was the spring of 1958.

Q. I ask you, again, when you speak of current cost are you talking of cost in September or October of 1958 or cost as of September or October, 1959, or are you talking as at December, 1958?

A. Well, all except the last item are as of December 31st, 1958. Exchange rates at that time on the cost which the company had to pay at that time were taken into consideration. I have given some consideration in connection with the ordinary stock to the market situation prevailing in 1959. I do not believe it has changed my views at all, but I felt I had to consider what was taking place in 1959 in order to give a proper expression of opinion here.

It is something that happened - something serious had happened in 1959 to change the figures for 1958. As a C.P.A. I would probably be barred if I did not make an adequate disclosure.

Q. During the period from December, 1958 until November or October, 1959, of course, the cost of money increased?

A. The cost of debt money has increased.

Q. Quite substantially?

A. Not to this company.

Q. I mean generally?

A. Generally, that is correct, sir.

Q. That is what the tables show?

A. The tables show that, yes, sir.

Q. Now, on this matter of rating, Mr. Smith, when you speaking of rating, you are speaking of a rating as to a particular security rather than as to a particular company?

A. That is correct, sir.

Q. So that the fact that the Canadian Pacific Railway is rated at the moment as Moody's standard and poor at Ba does not mean that any new financing that the C.P.R. may take will still maintain the same rate?

A. It would depend on the type of security, that's right.

Q. Just, again, from the point of clarification, Mr. Smith, in your Schedule 3, Sheet 3, under Baa, you state bonds which are rated Baa are considered as lower medium grade obligations;

that is, they are neither highly protected nor poorly secured. Should that not be "well secured"?

A. I wish I could get the rating agencies to give us a better idea of what they take into consideration. The words here are the words from Moody's. Behind the scenes, I can sometimes guess what goes on, and sometimes I can do a good job of guessing the ratings before the security is determined. But, I cannot get any more than what is here quoted by Moody's.

Q. Unless you are poorly secured, you do not get a higher rating; is that right?

A. That is right. Aaa rating is really well secured. You can depend on that.

Q. I wonder if you would mind checking, just for my satisfaction, that Baa that the Moody's report gives -- it would seem apparent that that word "poorly" is out of order.

MR. SINCLAIR: You mean a typing error? Yes. Yes, we will be glad to check that, certainly. I see what the incisive mind of Mr. Dickson is getting at. We will check it.

Q. And also on these collateral trust bonds which are rated Ba, Mr. Sinclair indicated that the question of security was a legal question.

A. Oh, no.

Q. It is not a legal question?

A. It is partly legal, but bankers look far beyond the legal.

Q. It is a matter of fact?

A. Pretty much with them, that is right.

Q. And if I referred to the annual report, 1958, of the C.P.R., an asterisk which would indicate that these are secured by a pledge of some of these 4 per cent perpetual consolidated debenture stock, that would indicate that the security is not a first charge on all the assets and undertakings of the railways?

A. I think that's right.

Q. If it were, it might well be entitled to a higher rate?

A. What I mean by that is there are some securities which come ahead of that.

Let me look at my schedule before I answer that question fully.

No, I am not sure as to that, except for the equipments. The equipments would come ahead of your collateral trust and your perpetual consolidated debenture stock.

Q. On page 6, you refer to Southern Pacific's $5\frac{1}{2}$ per cents, 1998. That is a twenty-seven year maturity. That would be regarded as a little long for a time security?

A. No, it is a low sort for railroads. Railroads used to issue fifty year bonds and in some cases one hundred years.

That has been changed. The Electric Utilities issue bonds for thirty -- sometimes for

thirty-five years.

There is one case - Commonwealth Edison issued bonds maturing at sixty years. Natural Gas companies have a hard time going on beyond twenty years. There has been a firming up in the term covered by the bonds and bankers are getting stricter. As money gets tighter, you can expect the period of loans to be shorter.

Q. This is pretty much an outside limit on terms; is it?

A. I would think so. I would think that thirty years would be the outside limit, and some shorter times would probably be required in a good many cases.

Q. Now, on the following page, page 7 you indicate certain U.S. securities of fairly recent issue. You do not give the maturity dates for the last four or five. I wonder if we could have that information?

A. Well, we can easily get it from Moody's.

Q. And these rates vary -- the rates that you have given here -- from 4 to 5½ per cent coupon.

A. I think that's right.

Q. Yes. So that you do get a wide swing, depending on any number of factors?

A. Let me put it this way. You do get swings based upon time, but a Aaa security -- two Aaa securities will sell very close together.

A I would think so. ...

... good many cases.

Q ...

A ...

A I would think so.

Q ...

May be one will sell and yield at 5 per cent, and the other one will have a yield of 5.05, or something like that -- if they are issued the same time.

Time has a big -- contains a big adjustment factor, because our market has been uncertain in rather recent months in this tight money situation.

There is one thing to bear in mind with the yield on seasoned bonds of a company. You take a company with Aaa bonds outstanding. The transactions on those bonds, which are often not very large, may show the yield to be 4.75 but if that company were to issue new bonds of the exact same grade -- part of the same mortgage; merely another series -- the chances are today's market would have to pay one-quarter per cent more.

Q. On the new issue?

A. That's right, sir. Yes, sir.

Q. Under the heading "Preferred Stock Capital", you indicate that none of the railways in the United States have issued preferred stock in recent years. That holds true to Canada, too?

A. It holds true to Canadian Pacific, certainly.

Q. And the Canadian National?

A. I think so.

Q. And if you were going to recommend to, say, the Canadian Pacific raising of new money, would you contemplate raising it by way of preferred shares?

A. No, I would not.

Q. Or the sale of common?

A. Oh, I would like to see them issue some common.

But let me go back to preferred. There is some possibility that the company could do so, and I am not sure that it could do so legally, but if it could issue convertible stock which is cumulative and which comes ahead of all the other stock outstanding, it is possible it could be marketed at a fair price. But that is the only kind of stock that I think could be marketed in today's preferred stock market.

Q. Have you discussed this with any Canadian underwriters?

A. I haven't, recently. I have from time to time talked to Canadian financial people. When I was here in 1952, I was associated with Mr. Nixon of Dominion Securities, and he and I had long discussions of Canadian situations.

Q. We know Mr. Nixon very well. But, have you discussed anything with him of this nature since --?

A. No, sir, I have not.

Q. Or, with any other Canadian underwriter familiar with the C.P.R.?

A. No, I don't think so.

Q. And in fact, in actuality, whatever the C.P.R. might pay for money in future would depend on what a particular Canadian underwriter or, say, two Canadian underwriters might find acceptable?

A. But the economies of Canada and the United States are linked together very closely, and if you find that money up here in Canada has a high rate, you have some United States money come up. And if we have a high rate in the United States, Canadian money will go down there.

I do not think Canadian Pacific can possibly float railway securities in Canada at a rate which would be greatly less than the rate for equivalent securities in the United States.

Q. You recognize the possibility of marketing in England where the C.P.R. securities are widely held and acceptable?

A. I do not think there is much possibility at the present time.

Q. On page 18 of your precis, Mr. Smith, you refer to a pay-out ratio of sixty to sixty-five per cent. It is a fact, is it not, that last year the ratio which the Directors of the C.P.R. considered appropriate was something in excess of that?

A. I think the Directors acted in reverse. They determined upon a dollar and a half -- to continue the dollar and a half dividend -- and that resulted in a ratio which was higher. I think it was approached in that way.

Q. Is it not a fact that they figured out seventy-one per cent?

A. I think that is fact. Over a period of years, they have paid out somewhat less

than sixty per cent. An average, I believe, for the ten years I have studied was 58.9 per cent.

(page 2952 follows)

Q. Just one final question in clarification of a question that was asked earlier this morning. You indicated that the difference between your figure for prefered share stock in Schedule 13 and that shown in Schedule 15 related to the fact that Schedule 13 did not indicate the actual amount received by the company. Is that your explanation?

A. I believe that is correct.

Q. Are you suggesting that the company's books would show the par value rather than the actual dollar value?

A. No. You have to keep books with par dollars and dollars on one side and discount or premium has to be shown elsewhere. When we come to cost of capital study we merely take the net proceeds. We take the two figures into the books and net them. Both are correct. One is the balance sheet presentation and the other is the cost of money study.

Q. And this breakdown which you are going to prepare will indicate how you have to handle the donation of grants?

A. The donation of grants has been handled so as to take out of the existing cost the donations of grants which were disallowed by the Board in the case on which I testified in 1952. I did not testify with respect to donations.

Q. The balance will be your outstanding equity?

A. Yes.

CROSS-EXAMINATION BY MR. FRAWLEY:

Q. I have just one or two questions of a general character. You make this presentation in the context of the study of the export grain rates -- the cost study with respect to export grain rates?

A. Yes. I understand that my study has to be calculated to make an allocation to the cost of the grain rates.

Q. But your study was simply a study in the field in which you have spent a good many years, and that is just the simple question of the cost of capital?

A. You can't get it any other way. It is impossible to compare equity bonds, common stock, equity preferred stock, existing many years ago with a particular rate. You get a rate. That is one thing. But the allocation of that rate is somebody else's job.

Q. Could the Canadian Pacific, if it accepts -- as I presume it will -- your calculation of this six per cent . . . it isn't 6½ per cent; it is 6 per cent.

MR. SINCLAIR: 6.5.

MR. FRAWLEY: Q. Of the 6.5 per cent -- then, the people who are actually causing the movement of the grain would take your figure and then apply it to the appropriate number of dollars of investment in the property, real and personal, that is used to move the grain?

A. Well, I don't want to take property by itself. They would make an allocation to the grain business.

Q. But it is a cost of capital to someone who

needed to buy property?

A. My difficulty is that I am not too familiar with the allocation method. You have peak use and off-peak use and things of that kind which do affect your allocation ratios. Maybe you call it a property ratio. I don't want to commit myself to something with which I am not familiar.

Q. But I suppose that this is so, that they will take your 6½ per cent, turn into a certain number of one hundred thousands of dollars and then they decide that is the cost of capital item that is involved in moving the grain?

A. That is one way. The other way, as I indicated, is to try to allocate first and then apply the 6½ per cent after.

Q. But this study was part of a general study to find out what the cost of capital to the Canadian Pacific Railway Company is?

A. To all railway enterprise, yes.

Q. And that, I put to you, is just as broad an approach to the question as the approach which you had in 1952 and 1953 when you testified as a witness for the Canadian Pacific?

A. It is not quite as broad, but it is in general line with the testimony I made then as to the cost of capital.

Q. Just starting, now, with the last answer you gave to Mr. Mauro -- because I just what to understand the force and purpose of your evidence -- you told Mr. Mauro -- I think he was dealing with the question of

[illegible]

dividends alone in the requirements formula, and he pointed out that it was roughly in the neighbourhood of twenty or thirty million dollars and he put it to you that, using your calculations, it would run your dividends up to about $50 million, or an increase of somewhere in the neighbourhood of $30 million. The note I have of your reply to Mr. Mauro was that unless the Canadian Pacific gets that it is not going to take its place with other companies in Canada . . .

A. That is right; they are not going to be able to raise the necessary equity capital like other companies; and there will be an erosion of capital, which is always a serious thing.

Q. What you say is -- and I am paraphrasing what you said -- the rate base, or the rate of return category -- whatever you will -- what you say is that that is the number of dollars that they must have to keep the company respectable in the money markets?

A. I have not put it that way. I am concerned more -- I have approached it from the rate base angle. I have been instructed to make a study and report on the cost of capital to the railway enterprise of the Canadian Pacific. I have done precisely that.

Q. That is true, but what I say is that you have agreed that it would be necessary to lift those amounts of dollars which the Board has allowed as the permissible level of allowance, and you would say that they have got to go up from something in the order of twenty to something in the order of fifty?

A. I am not sure of those figures. Those

figures were read to me. But accepting the figures, that is the answer. I don't see how you can get a dividend of 4 per cent, or 3 per cent, or 5 per cent on a railroad enterprise when you compare it with the finally selected figure on earnings of 11 per cent in the United States. When the United States Government gets anything it has to pay what the market price is. The Canadian Pacific will do the same.

Q. I am not too clear that I understand you when you say you don't know what the figures are. On that, I am looking at page 12 of the Board's Judgment of November 17th, 1958. I find there -- and there may be more recent figures, but these are the last ones I have, under the heading "Dividends" -- dividends in preferred stock, 4 per cent, $3,012,000 -- leaving out the hundreds; and dividends on ordinary stock, using 5 per cent, $17,500,000 -- again leaving out the smaller figures; so that would be of the order of twenty. But you say that, whatever you call it —the requirements method or whether you call it the rate base and rate of return method, those dollars should be available because the company needs them to take its place with other companies seeking capital.

A. It needs them to do that.

Q. You haven't attempted to -- what some of our friends say -- price this out in terms of freight rate increase?

A. No.

Q. I would like to put to you some words I find on page 252 of Volume 70 of C.R.T.C. -- and this is

[illegible]

the rate base and rate of return case -- and in that Judgment Mr. Justice Kearney read from page 212 -- the correct citation of the case is 70 C.R.T.C. 186, and I am reading from page 252.

These were the remarks of Mr. Justice Kearney:

"Mr. MacPherson, in his opening remarks, commented on the terms 'rate base' and 'net rail investment' as follows: 'The Canadian Pacific in its application asks for the establishment of a rate base and the fixing of the rate of return thereon by this Board. In their evidence they have used over and over again the term 'net rail investment.' May I spend a moment just commenting on the use of the term? To us from the provinces the term 'net rail investment' holds no terrors and presents no cause for real alarm. But the term 'rate base' as used, even though it may be suggested it is synonymous, has a sinister meaning . . . '"

MR. SINCLAIR: Who is he quoting?

MR. FRAWLEY: He is quoting Mr. M. A. MacPherson, counsel for Saskatchewan.

"'. . . but the term 'rate base' as used, even though it may be suggested it is synonymous, has a sinister meaning. There is something ominous and baleful about it for the simple reason that its mere use means . . .'"

-- and this is the part I want to read to you, Mr. Smith ---

"'. . . There is something ominous and baleful about it for the simple reason that its mere use means that a multiplier termed 'rate of return' must be supplied to complete the picture, and rate of return on what Canadian Pacific Witness Nixon . . .'"

-- that is the same gentleman you were referring to a moment ago ---

"'. . . at page 240 of the transcript testifies means $79 million more in revenue which must come from freight, or, in terms of freight rate increases, an additional 35 per cent increase...'"

Now, have you had any regard to the possible effect of lifting the permitted level of earnings, as we now have them before the Transport Board, to the $93 million which, I think, was another figure which you gave Mr. Mauro, and which would be the result of applying the 6 per cent?

MR.SINCLAIR: Could I have that question read back?

THE CHAIRMAN: Yes. The reporter will read the question.

---(Reporter read back the following question:

"Now, have you any regard to the possible effect of lifting the permitted level of earnings, as we now have them before the Transport Board, to the $93 million which, I think, was another figure which you gave Mr. Mauro, and which would be the result of applying the 6 per cent?"

MR. SINCLAIR: The $6\frac{1}{2}$ per cent.

MR. FRAWLEY: Q. Have you made even a rough calculation of what that lifting of the dollars which, you say, the Canadian Pacific should be allowed to determine -- call it the rate base and rate of return, or the requirements method -- call it what you will -- have you given any thought to what that would require in terms of freight rate increase . . . ?

MR. SINCLAIR: I thought that was what he was going to ask, and I would say that that question should be put to Mr. Crump rather than to Mr. Smith.

MR. FRAWLEY: I am cross-examining Mr.Smith, and I am certainly not going to be cut off from so doing.

MR. SINCLAIR: You read something which, you told me, was by Mr. MacPherson, from Volume 70 of C.R.T.C. at page 186, and I presume you will agree that Mr. MacPherson was saying something that he had to say as he was instructed to say. Would you not agree?

MR. FRAWLEY: I don't know anything about his instructions.

MR. SINCLAIR: You wouldn't think that this was other than something from Argument of counsel, or suggest that it was anything more than an attempt to convince somebody from the facts he had at his disposal and in accordance with the instructions of his client?

MR. FRAWLEY: Let us not worry about my friend's suggestion about the "instructions of his client . . ." ---

MR. SINCLAIR: My friend?

MR. FRAWLEY: Yes, you are still.

THE CHAIRMAN: I think this would be a good time to adjourn!

---Luncheon adjournment.

(Page 2963 follows)

--- On resuming at 2:00 p.m.

CROSS-EXAMINATION BY MR. FRAWLEY: (cont'd)

THE CHAIRMAN: All right, Mr. Frawley.

MR. FRAWLEY: Q. Now, Mr. Smith, just at the noon adjournment my friend, Mr. Sinclair, I think he was on his feet objecting to what I was putting to you from page 252 of 70 CRTC, and all I was putting to you was a statement from Mr. MacPherson, counsel for Saskatchewan, in that case, the fair rate of return case, and I was quoting from what Mr. MacPherson had argued, if you like, to the Commission, and what the Commission itself, the Chairman of the Commission, was putting into his judgment; he was putting into his judgment, Mr. Justice Kearney, a passage from Mr. MacPherson's opening remarks.

Now then, we have got the background and know what we are talking about, and the part that I am particularly calling your attention to was the place where Mr. MacPherson was referring to what the Canadian Pacific witness, Mr. Nixon, had said at page 240 of the transcript, which was - and I hope I am not unduly paraphrasing it, and perhaps if I wait until my friend get's the passage he will see that I am not unduly paraphrasing it, and we can look at it together.

I was putting it to you that Mr. MacPherson was saying in this passage which Mr. Justice Kearney was quoting from, Mr. MacPherson was referring to what the Canadian Pacific witness,

Nixon, had said at page 240 of the transcript, which was to the effect that $79,000,000. more in revenue, which must come from freight, would mean an additional thirty-five per cent increase in freight rates.

Now, that is all I was putting to you, and so that you will have it in front of you so that you can confirm this yourself, I will just give you that page there, and assuming that Mr. MacPherson's quotation of the witness, Nixon's testimony, was correct, and that Mr. Nixon's $79,000,000.00, additional dollars to the Canadian Pacific as its rate of return on the rate base and I put it to you that if Mr. Nixon's increase of $79,000,000 - it is at page 252, I think it is down on this side of the page - $79,000,000 meant a thirty-five per cent increase in freight rates, then I put it to you that your additional $39,000,000 - call it $40,000,000 - that your six per cent would probably mean an immediate increase in freight rates of about 17½ per cent, and I want to know whether you agree with me that that would be the result?

A. Well, I agree with you in part and disagree with you part. I don't think we are dealing with rate making on immediate increases in rates of that magnitude, and I think it is somewhat more flexible.

Also, on the other hand, the matter of compensation or capital, which I have shown here

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as being required if the company is going to continue to attract the capital - because you have to pay for capital as you have to pay for labour, and if you don't pay the price of labour, you don't get it, and if you don't pay the price of capital, you don't get it; that cost is there and it must be paid for if you are going to get the capital. As to the percentage of increase, I don't have the revenues, but I think it would be substantial. That can be computed, Mr. Frawley.

Q. So that we will understand each other, you say that the railway needs so many millions of dollars over and above its operating expenses to make it respectable in the market place when it goes to borrow money?

A. That is right, it has to have an opportunity to earn that and has to earn it if it is going to continue to get capital.

Q. And you say the way to give them these dollars is to apply six per cent, to apply the rate of return of 6.5 per cent on its property investment.

A. That is summarizing my testimony very briefly. The way to determine it is to try to find the cost of capital.

Q. The $6\frac{1}{2}$ per cent is not to be left in the air, it is to be turned into so many millions of dollars.

A. That is the end result of my study.

Q. What you say is whatever number of dollars emerges from using the $6\frac{1}{2}$ per cent, that in

your opinion is the proper number of dollars to allow the company?

A. That is the number of dollars I say this company has to get to recover its costs, and it has to recover its costs if it will continue to attract capital.

Q. What you say, if my figures are right, you would say there is sort of a shortcoming in the present requirements formula; that is it would be $51,000,000 as compared to $93,000,000, which is about $39,000,000?

A. Your "present requirements formula" disturbs me somewhat, because Mr. Justice Kearney stated he didn't close the door when he considered all investment in the future.

Q. That is quite right. And now, just so that there will be no question about what went on there, I am just going to take a minute to read you just two or three short passages, and at page 263 Mr. Justice Kearney said on that same case:

> "Mr. C.W. Smith, on the other hand, while admitting the railway field was not his speciality, was of the opinion that the rate-base-rate-of-return method as a determining factor would prove as practical for railway utilities as it had been in gas, telephone and other light utilities."

And then, reading from what Mr. Justice Kearney said at page 267:

"In summary, therefore, the Board is of the opinion that, in the long run, it would be disadvantageous to the interests of the public, the railways and investors alike to give, through the implementation at this time of the Canadian Pacific proposal, any appearance or inference of certainty of solution of a nation-wide rail transportation problem for which, under present conditions, no certainty exists."

Then I would just like to read one final short paragraph:

"It need hardly be stated that as we have declined to establish a rate base as requested in para. 1 of the application it follows we would decline to fix 'a fair rate of return on such a rate base', ie, at a level of not less than 6½ per cent as requested in para. 16 or, for that matter, at any other percentage level."

All I want to put to you in conclusion, Mr. Smith, is ---

MR. SINCLAIR: Just a moment.

MR. FRAWLEY: Mr. Sinclair asks me to put something else in which he thinks should be read over with it, and I am very glad to do so. There are two paragraphs there - I see that you have underlined some things in red, so to be safe I will

go back a bit more and take in a little more than you have underlined in red.

MR. SINCLAIR: I think the judgment has to be read in its entirety.

MR. FRAWLEY: I would think so. It is a long judgment, but I would certainly indeed commend it to the reading of the Commissioners in view of the fact, in my respectful submission - and I don't want to get into an argument - this witness has not changed the situation one iota in his presentation here than he presented away back in the far off days of 1952.

MR. SINCLAIR: That is an argument to be made at a later time.

THE COMMISSIONER: As I understand it, his evidence was directed to a rate base and rate of return, and today he is taking the stand, as I understand his evidence, that it is purely an academic question, and whether it is rate base or requirements, cost of capital is involved; that is the evidence today.

MR. FRAWLEY: I will just read two paragraphs to satisfy my friend, and I will read this paragraph from page 279 of 70 CRTC:

> "Factors such as the cost of raising capital or the cost of money, as it is called in the financial world, and the need for new capital are variables which change with the times, and other changing conditions which affect rate-making have occurred in

the last twelve months the effect and extent of which the record in the present case does not disclose and which we will refer to more fully in our notes on confiscation.

I consider, therefore, that even if the Board were disposed to declare what constitutes a return on the net rail investment of Canadian Pacific which would be fair to all parties concerned, it should not attempt to do so in a vaccum but only if and when a specific application for an increase (or decrease) in tolls and rates is before the Board and is supported by the required timely and pertinent evidence. I might add that, without repeating them, other reasons which we have given as to the inappropriateness for the Board to make a declaratory judgment that a 6½ per cent return is fair for Canadian Pacific they also apply to any lesser percentage which might be sought by way of a declaratory judgment and for the foregoing reasons we consider that we should decline to do so."

I am precluded from commending these words to the Commission, because Mr. Sinclair is presenting Mr. C.W. Smith in just the same kind of vacuum today as he presented him in 1952.

MR. SINCLAIR: All I can say to that

remark, and I take it there is no question to the witness, Mr. Frawley?

MR. FRAWLEY: No, no further questions; you just asked me to read another passage.

MR. SINCLAIR: I thought you wanted to put a question to the witness.

MR. FRAWLEY: No, I have no further questions; I have sufficient answers through the witness. He was concerned about the context in which the Commissioners themselves in the rate base and rate of return case had left the matter, and for that reason I read two or three passages into the record to indicate that I understood the purport of the Board's judgment in that case.

MR. SINCLAIR: Now, Mr. Chairman, and members of the Commision, some of us happen to be a little more familiar with the background of this matter than others to which Mr. Frawley has referred, but I do think to assist us all in dealing with the point that was raised by Mr. Frawley and the reason I asked him to read that last bit was that that was an application to the Board for a declaratory judgment in the future concerning the overall method of arriving at the level of permissive rail income, and I want to make it clear that I think the evidence has made it clear and I think, sir, that you have stated it better than I can and I am much obliged to you for that, that that isn't what we have for this Commission at all.

THE CHAIRMAN: We are not discussing method.

MR. SINCLAIR: We are not discussing method, nor are we discussing what would be a return that would be fair if we were fixing the overall net rail income which we might say should be fixed, nor, Mr. Chairman, are we in any way saying that this is rate base and rate of return, because if it was and that was our submission to you, we would have additional evidence and different evidence to give to that which we have given to the Commission, and I just wish to make that point clear.

(Page 2975 follows)

MR. MAURO: I certainly don't want to interfere with my learned friend's explanations, but I think that the testimony of this witness is pretty clear, that when we apply -- and I asked him this morning as to what this would mean in the permissive level of earnings, and Mr. Smith very candidly said that if my figures were correct the 6.5 would be taken----

THE CHAIRMAN: Well, that is what I understand, too, that the cost of capital is in issue and that involves other questions which are academic in there.

MR. MAURO: That is quite right, Mr.Chairman.

MR. SINCLAIR: Well, of course, my friend -- possibly I can clear up one point in re-examination.

THE CHAIRMAN: Any other questions? Mr. Doherty?

MR. DOHERTY: I have no questions.

THE CHAIRMAN: Mr. Wood?

MR. WOOD: No questions.

RE-EXAMINATION BY MR. SINCLAIR:

Q. Mr. Smith, in arriving at the calculations, the arithmetic gymnastics, or whatever you wish to call them, that were put to you by my friend Mr. Mauro, he referred to a figure on dividends; that is, I take it he meant payments under a given number of shares. Now, in your cost have you worked towards outstanding shares in arriving at any of the costs that you have arrived at?

A. Well, I have worked on total ordinary stock equity.

Q. Has that got anything to do specifically

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with dividends as such?

A. Yes, I said in arriving at my conclusion that I thought that 6 per cent on ordinary stock equity was required in order to put the company in the position to attract capital.

Q. Would I be wrong, Mr. Smith, to suggest that is a combination of dividends and surplus?

A. No, that was a dividend on equity, the 6 per cent.

Q. A dividend on equity investment?

A. That is correct, sir.

Q. If we take a look at a Judgment that was referred to here by my friend Mr. Mauro in his calculations, he made reference to a figure of dividends, twenty million odd, and then right below that is a further figure of $15,235,000 and again below that another figure of $2.4 million.

MR. FRAWLEY: You are referring to page 31 of the pamphlet copy of the Judgment?

MR. SINCLAIR: I am.

Q. When you are talking about dividend earnings on equity, would you take into account these items?

A. These items are set out in a rather unusual fashion. The 55 million ---

Q. I am talking about these three.

A. Well, I arrived at it in a different fashion. The 55 million would compare to my 9¼ per cent or so on the common equity. But I did not try to ---

Q. Mr. Smith, I think that you have not seen those figures, and I think that doesn't compare with your $9\frac{1}{4}$ per cent on the common equity at all.

MR. FRAWLEY: Take out the 16 million.

THE WITNESS: There are some fixed charges here which do not apply, that is correct.

MR. FRAWLEY: And the rest is all equity capital.

MR. SINCLAIR: Q. Mr. Smith, the return on equity that you arrived at to arrive at your composite rate would take into account all items of dividend and surplus if they were separated as to requirements?

A. Yes, that is correct.

Q. So it would be wrong, would it not, to compare 20 per cent and the $6\frac{1}{4}$ on 847?

MR. FRAWLEY: That is a pretty leading question for your own witness.

THE CHAIRMAN: Well, let's leave it to argument.

THE WITNESS: I did not think that the Board fixed a dividend, I thought it rather made a computation. If it is computation that we are talking about, I would say I arrived at my $9\frac{1}{4}$ per cent by saying that the stockholders today would have to get 6 per cent on their equity plus something for surplus in order to attract investments. The 6 per cent can be computed and the $9\frac{1}{4}$ per cent can be computed if they apply to the equity I assume in Schedule15. I stated I thought the dividend tested at this particular time was a better test than the earnings price ratio. The earnings price ratio

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then would have given a higher figure. I thought it was more realistic in view of the financial position of the railroads.

Q. Do you know or do you not know whether the $20 million referred to by my friend Mr. Mauro when he referred to these figures that were before the Board in 1950 reflects a 5 per cent factor on the issued shares of Canadian Pacific?

A. I understand so.

Q. Now, Mr. Smith, if you were giving evidence in this court room on the overall level of permissive earnings, and you were giving evidence as to what would be a fair return on the capital used in transportation service, would there be factors that you would take into account that are not taken into account in a cost of capital study as you have presented it here?

A. I would want to take into account further factors. I have used what is generally termed bare bones cost of capital, and I would like to take into consideration a few other arguments. They would not have a very substantial effect upon my answer, but they would modify it somewhat.

Q. In which way?

A. Upward.

Q. In some question put this morning by Mr. Cooper he referred to time studies in respect to debt capital, and I think your evidence was that you took the historical cost of debt in arriving at the composite cost of money?

A. Yes.

Q. That was your answer to Mr. Cooper. If you had taken present cost of debt in arriving at your cost of money, what would the effect have been on the answer that you came up with?

A. It would increase the answer substantially, but I would not use the current market price of capital. But it would change the answer substantially by increasing the overall end figure.

Q. What was the overall cost of debt as you used it in arriving at your composite rate of 6 per cent?

A. I believe it was 3.33 per cent. That is correct.

Q. And as of the end of 1958, what would be the current cost, roughly speaking?

A. Oh, the current cost at the end of 1958 would be somewhat in excess of 5 per cent. I will take that back. I am not sure about 1958, but in 1959 it would have been over 5 per cent. I think it would have been somewhat less than that at the end of 1958, maybe 4.98 or something.

Q. And then in respect of another point -- in arriving at your rate of 3.3 per cent, I think you said that that was total debt?

A. Yes.

Q. And in your study you also took historical cost preferred capital; is that correct?

A. That is correct.

Q. As it existed at December 1958; I think that is what you told my friend Mr. Cooper?

A. That is correct.

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[illegible]

Q. If you took the present cost preferred capital, what would have been the rate in 1958?

A. I have grave doubts that Canadian Pacific could issue preferred stock. If it did, it would have an accumulative preferred stock, perhaps have it convertible as well. That stock would have been in excess of 6 per cent. But it is difficult to speculate, to try to pin down to a particular percentage.

Q. One of my friends asked you if the evidence that you gave in 1952 and the purpose of your study were the same, and, to make it clear, your answer that you gave me earlier that you would go to the other factor, would that go to the same point?

A. Yes, that would go to the same point; and while certain approaches were the same, the data in 1952 is quite different to what they are today in many respects.

THE CHAIRMAN: Mr. Smith, on page 7 you referred to the five issues in 1958, and there is quite a spread there, from 4 to 5½ per cent, the issues, the rail issues in 1958. Now, would all these securities be sold at par or would there be a discount in the 4 per cent?

THE WITNESS: I think all of these were sold at par.

THE CHAIRMAN: So the effect of rate would not change from the coupon rate?

A. That is correct; I would not have used the coupon rate.

THE CHAIRMAN: So the point of your evidence

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is that ratings determine the amount on the coupon?

THE WITNESS: Well, it depends upon timing in these things. There has been such a drastic change in the market. I have seen conditions within two months change where a double "a" bond would have brought a different price if it had been issued two months previously. In other words, the Wall Street Journal is making a practice now that when a few months ago a particular company issued double "a" bonds it cost so much. The trend has been upwards, but not steadily, it has been in a zig-zag fashion.

THE CHAIRMAN: But your information is that they were par?

THE WITNESS: I think they were. The one exception, I think, is the Virginian Railway, which, of course, is a very prosperous railway in the Pocahontas area. It had 4 per cent there. I don't know; the 4 per cent seems awfully low at that time. But the Virginian has been a very prosperous railroad.

THE CHAIRMAN: It is rated double "a"?

THE WITNESS: Yes, but even then it seems low for that particular time. The rating and the time both have an effect on the cost of the capital.

THE CHAIRMAN: When you hit the market?

THE WITNESS: Yes, and there is a lot of guessing going on today.

THE CHAIRMAN: Thank you, Mr. Smith.

Mr. Toole?

MR. McDONALD: Mr. Toole's evidence in chief was given on December 17th; it is Volume 20

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at pages 2889 to 2892, and he is now here for cross-examination.

THE CHAIRMAN: Mr. Cooper?

MR. COOPER: I have no questions.

THE CHAIRMAN: Mr. Cumming?

MR. CUMMING: Thank you, Mr. Chairman.

JOHN L. TOOLE, recalled

CROSS-EXAMINATION BY MR. CUMMING:

Q. Mr. Toole, at the time you were giving your evidence before at page 2890 of the transcript, you stated that Canadian National adopts the rate of 9¼ per cent as the cost of equity capital and that you did so for the reasons contained in the Canadian Pacific memorandum, the evidence on which was given by Mr. Smith. I was wondering, sir, whether or not Canadian National conducted any independent studies or inquiries of its own to determine the cost of equity capital, or are you simply relying on the evidence that was given by Mr. Smith?

A. We have done some cross-checking on Mr. Smith's evidence, and we have agreed in discussions with Mr. Smith, and through that we have adopted the principles he has enunciated here.

Q. As a result of checking and those discussions, you were satisfied with Mr. Smith's views on the question?

A. That is right.

Q. Mr. Toole, am I correct in the understanding that the last capital revision of the Canadian National Railway System was that made under the Capital Revision Act of 1952?

A. That is right.

Q. There has been none since that date?

A. None since then.

Q. Going on to page 2890, you told us that

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1. [illegible]
2. [illegible]
3. [illegible]
4. [illegible]

the capital requirements of Trans-Canada Air Lines are provided by Canadian National Railways. Could you tell us, Mr. Toole, just briefly, what are the terms of the agreement or arrangement under which the capital requirements of Trans-Canada are supplied by Canadian National?

A. It is merely an arrangement for convenience so that when we go to the public to refinance the temporary loans there is only one approach to the public and, consequently, their requirements are lumped with ours for that particular purpose, and we pass on to TCA the exact cost of the issue for their portion of it.

Q. And I note from Exhibit 76A that you have subtracted or deleted those capital commitments or amounts which relate to Trans Canada?

A. Yes, that capital is not employed in the rail business.

Q. Now, in your evidence, you go on on the same page to point out that the one hundred million dollar debenture issue and some almost $17,000,000 in working capital advanced to the Canadian government railways are non-interest bearing and that they have been transferred from long term debt to shareholders' equity, in Exhibit 76A?

A. That is right.

Q. Firstly, sir, can you tell us what lines are comprised in the Canadian Government Railways, just as a matter of information?

A. The principal ones making up the Canadian Government Railways here are the ones in the Maritimes under that principal name which, I think, was known as Canadian Government Railways in the Maritimes and the National Transcontinental which ran across the northern end of the country north of the C.P.R.

Q. Does that include what is known as Inter-Colonial?

A. I believe it does.

Q. Can you tell me, sir, when these amounts that are referred to -- that is the one hundred million dollar debenture, firstly, and this advance of working capital -- when each of

those sums will become interest-bearing -- they are not bearing interest at the present time ---

A. No.

Q. --- and at what rates?

A. Oh, I would not like to guess on that. $100,000,000 comes up for reconsideration in 1961 -- January 1st, 1961. I cannot foretell what will happen there.

Q. The rates, I take it, then, is a matter to be negotiated; is it?

A. If the $100,000,000 stays in its same form, yes.

Q. And what about the roughly $17,000,000 of working capital advanced to the Canadian Government Railways? Have you any idea when that will become interest-bearing?

A. Most of that has been there since about 1923, and it has been in that approximate amount ever since then -- never interest-bearing.

Q. I suppose you would anticipate that it will continue in that same position; do you?

A. So far as I know

Q. As and when the $100,000,000 debenture becomes interest-bearing, would that be re-transferred to the long term debt sub-heading of the Balance Sheet rather than Shareholders' Equity?

A. It depends on the form it would take. At this particular time, it is capital employed in the business without interest, so that it represents an investment similar to share capital.

Q. But if it becomes an interest-bearing debenture, then I would assume that it would be classed as long term debt; would it?

A. Yes, yes.

Excuse me, if it was interest-bearing on the long term form.

Q. Yes. I see what you mean.

In answer to a question by Commissioner Anscomb with reference to this recent $300,000,000 issue, you said, at page No.2892, that the effective rate on that issue was 5.93 per cent.

Now, you had said earlier that if the debt of Canadian National was refunded that, as at December, 1958, it would cost the company an average rate of at least 5.10 per cent.

Is your estimate of that cost affected by the experience you have had with this recent issue?

A. I think I have to appreciate how the 5.10 per cent was given. It was given in relationship to the debt outstanding at the end of 1958, and it is calculated on the assumption that we had gone to the market in December, 1958 and at that time our best judgment was that if we had gone to the market, 5.10 per cent would have been the approximate cost.

Q. That would have been cost at that time?

A. At that time. And that is related only to the short term monies that we had in hand

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that could ultimately go into long term with the public.

Q. And, of course, if you were to make a similar estimate for a later period of time you would take into account such changes as there have been in this intervening period?

A. Yes.

Q. And I assume, then, that that change would be a change in an upwards direction?

A. While the evidence is that in May of of 1959 we went to the market with $150,000,000. issue, that cost was 5.21 per cent. You notice it is just a shade over our 5.1 which we estimated for December. And, later, as you know -- you have referred to it now -- the 1959 and January 1st, 1960 issue is at 5.85 and 5.93, respectively.

Q. And 76A -- that has been derived, as I understand it, from the 1958 annual report which is Exhibit 77?

A. That is the evidence of the amount of long term debt and the shareholders' equity in existence.

Q. And do you have Exhibit 77 before you?

A. Yes.

Q. I am looking at page 27.

A. Yes.

Q. And looking, as well, at Exhibit 76A, on Exhibit 76A the long term debt is shown as $1,333,955,601. And on the Balance Sheet, Exhibit

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77, that figure is $1,518,600,669.

Now, the difference, just so that I have it clear, is the larger figure less the loans and investments in Trans Canada, and less these two sums that have been transferred to shareholders' equity; is that correct?

A. That is right. The exclusion for Trans Canada naturally is related to debts in that top figure. There is also an exclusion later on related to capital. That is related to equity.

Q. And, on page 33 of Exhibit 77, Mr. Toole, are set out the particulars of the long term debt of Canadian National, and I want to draw your attention particularly to the last four items under the heading, "Bonds, Debentures and Equipment Obligations."

There are four series ST, U and V of Equipment Trust Certificate referred to there.

A. Yes.

Q. Can you tell us when those several series were issued?

A. You will note, first of all, I think we only need to refer to the last two, because they are the only two that are outstanding.

Q. The first two have been retired?

A. The first two have been retired. The March 15th, 1960 was issued on September 15th, 1950.

Q. Yes?

A And the other issue, January 15th, 1961 maturity, was issued July 15, 1951.

There have been no equipment trust issues since then.

Q. In Mr. Smith's evidence, Mr. Toole, he gave us the particulars of some Canadian Pacific Equipments in recent years. There are four of them and they are referred to at page 8 of his memorandum -- an issue issued on April 1, 1953, due 1963, which cost 4 per cent; another one issued January 2nd, 1954, due 1969, which cost 3.83 per cent; and one issued August 1, 1954, due in 1962, costing 3.10 per cent. The fourth one is considerably later.

Can you tell the Commission why there would be such a spread between those rates and the rates at which the Canadian National Equipment Trust Certificates were issued?

A. Well, the first thing I would note is that the dates of issue were somewhat different.

Q. Somewhat later?

A. Yes. And I assume -- and I can only assume -- that it was market conditions at the time.

Q. Just a question of changing market conditions?

A. Yes.

Q. The first one is perhaps the closest in point of time, issued April 1, 1953, which was not after the last of the ones to which you referred, and there is a difference of 1¼ per cent.

A. I cannot say more than it must be the market conditions at the time of issue.

Q. Even in that short space of time?

A. Yes.

Q. Now, further down that same page of Exhibit 77, page 33 of it, Mr. Toole, there appears a figure for the total Government of Canada Loans and Debentures, which I note were reduced from 1957 to 1958 by a total of almost $140,000,000 -- to be exact, $139,176,152. Do you see that figure?

A. Yes.

Q. Can you tell us whether it is anticipated there there will be a further reduction in that total obligation for the year 1959?

A. Yes, there will be, because this reduction is the action of refunding the temporary loans which we have obtained from the Government, and replacing it in the hands of the public.

Up above, you will see a $300,000,000. figure in the long term debt transactions during 1958. Some of that $300,000,000 was used to wipe out the short term borrowings which you see follow as a reduction.

Q. Will that reduction of this particular obligation have any effect, either upwards or downwards, because of its replacement with some other obligation, upon the composite cost of capital which you show in Exhibit 76A?

A. As I said, the cost which we have shown here for funded debts is a condition at the end of 1958, and to the extent that interest rates have gone up since 1958, and we have demonstrated that they have in our two recent issues, it means that, well, our cost would go up. But this statement,

if it was re-calculated, shall we say, as of the 1st of January, 1960, we would come up with a higher end figure than we have here now.

Q. I see. And that would apply in spite of the reduction of this class of obligation ---

A. Partly applies, because of that reduction, because we are reducing our short term borrowings and replacing them with long term borrowings at higher rates.

Q. I see. Now, under the heading a little further down on page 33 of Exhibit 77, under the heading, "Shareholders' Equity", there is an increase of nearly $21,000,000. in 4 per cent preferred stock between 1957 and 1958.

A. Yes. That refers to a provision of the Capital Revision Act of 1952 under which Canadian National Railways obtains new issues -- I should say -- preferred stock for cash to the extent of 3 per cent of revenues. It is a 4 per cent preferred issue based or calculated at 3 per cent of revenues.

(Page 2997 follows)

Q. That will increase as the years go by, will it?

A. That provision of the Capital Reserves Act runs out in 1961. I can't tell what will happen after that.

Q. In giving your evidence, Mr. Toole, at page 2891 you told us the rate of 9.25 per cent had been applied to the total of the shareholders' equity to produce a rate of $167 million, and so on. I take it that equity, to the rate of 9.2 per cent, includes the $100 million debentures ?

A. That is right.

Q. In the way that Exhibit 76A is drawn?

A. That is right.

Q. And it includes, as well, the $70 million approximately of working capital advanced to the Canadian Government Railways?

A. Yes.

Q. What I want to ask you is: by reading these items the $100 million item is equity rather than debt capital; and, therefore, applying the 9.25 per cent rate to that does that not have the effect of inflating, to some extent, the composite cost of capital which is shown on Exhibit 76A?

A. It definitely has the effect of making the composite cost just slightly higher than if it had been excluded; but the $100 million is included on the basis that it is money that is at work within the system; and it is just a technicality that there isn't a share certificate to represent it.

[illegible]

Q. I see; and, of course, I suppose that the object of that is that when this $100 million finds its way back to the long-term debt heading then the impact of that cost would be, to that extent, reduced?

A. Yes; and we did make the calculation that the impact is very minor. It is in the 6.95. If you excluded the $100 million it would be down to 6.56.

Q. A difference of .09?

A. Yes.

MR. CUMMING: Thank you very much.

THE CHAIRMAN: Mr. Toole, the cost certificates -- are they held by Canadian holders, or American?

THE WITNESS: I am not sure that I have that. Excuse me ---

THE CHAIRMAN: Are they held by insurance companies? I take it they buy them?

THE WITNESS: They are sold to syndicates on one side of the trust. I don't know the companies offhand, who bought these particular issues.

THE CHAIRMAN: Were they bought by Canadian institutions, or American?

THE WITNESS: I would be guessing to answer. I expect it was Canadian, but, I mean, to the best of my knowledge we have never sold them in the United States.

THE CHAIRMAN: Mr. Frawley?

CROSS-EXAMINATION BY MR. FRAWLEY:

Q. Mr. Toole, were you aware that the Canadian Pacific made a proposal to the first Turgeon Commission which suggested that there be an amendment to the Railway Act to provide that . . . "Rates shall not be deemed to be just and reasonable unless, taken as a whole, they are sufficient to provide a fair return upon the investment in the railway property of Canadian Pacific Railway Company . . ."

A. I am aware of it, yes.

Q. And are you aware that the Canadian National Railways opposed the proposed amendment?

A. I don't recall the terms.

Q. Well, page 63 of the first Turgeon Report says: "The Canadian National Railway Company opposed the proposed amendment as did all the provinces appearing before the Commission except Prince Edward Island and Newfoundland, neither of which discussed the proposal."

In any event, at the moment you are allying yourself with the work which Canadian Pacific did to ascertain the cost of money?

A. That is right.

Q. And your own statement makes that particularly clear, Exhibit 76: "Canadian National agrees with the principles enunciated in the memorandum submitted by Canadian Pacific Railway regarding cost of capital . . ."

A. Yes.

Q. " . . . Canadian National adopts the rate

of 9.25 per cent as the cost of equity capital for the reasons outlined in the said Canadian Pacific memorandum"?

A. Yes.

Q. And you say in your evidence that you have developed this cost of money to be included in the cost of transporting grain and grain products going at statutory rates to export positions?

A. Yes.

Q. In other words, that is the purpose of it; it is to find the cost of capital and apply it to the cost of moving the grain so that it will appear as an expense of moving the grain?

A. Yes.

Q. And, in fact, going to page 38 of Mr. Bandeen's exhibit 57 -- I am reading from page 38 -- Mr. Bandeen says: "The cost of money invested was taken to be 6.5 per cent. This cost is an alternative cost of money or the rate which should be earned if invested in a similar enterprise. After allowance for the payment of income taxes on other than the fixed charges the rate on investment before income tax must be 10.96 per cent . . .", or virtually 11 per cent?

A. Yes.

Q. Now, I don't know, Mr. Toole, but am I to understand from that that the Canadian National is suggesting that this cost of moving grain should be such as to enable Canadian National to earn, before income tax, 11 per cent, or the investment that it has in the grain-moving equipment in Western Canada?

A. The 10.96 per cent, yes.

Q. That is correct?
A. Yes.
Q. How far short are you of such a rate now?
A. Very short.
Q. Well, so short that, as is well known, you have to go to Parliament for moneys to meet your deficit?
A. That is right.
Q. But, nevertheless, because the Canadian Pacific says it should have 6.5 the Canadian National. . .
A. No; if I could give you a little more background on that, the Canadian National is operating as a corporation the same as Canadian Pacific is. It has share capital and bonds and has a directorate, and is operated in a competitive climate. We, therefore, must gauge our operation on competitive bases, and one of those bases is the cost of operation; and if we are going to prevent any imbalance in that competitive climate we have to consider all competitive forms, including the agreed 9.25 per cent.
Q. It would not have been realistic if you had taken Canadian National into that situation, where ---
A. Completely unrealistic.
Q. --- where it was required to operate as a deficit?
A. Yes.
Q. As to just exactly what it cost the Canadian National in financing, I was under the impression that you borrowed at a rate which was a Federal Government guaranteed rate?
A. Our securities -- and we have mentioned

two or three issues here this morning -- they all carry a government guarantee.

Q. And the Canadian Pacific hasn't got any such privilege?

A. No; to that extent there is a difference in the background of our costing, because presumably we could not get it to that extent without the government guarantee.

Q. It seemed to me obvious that if you are borrowing at a Federal Government guaranteed rate and, therefore, at a lower rate, it is not realistic to go along with the situation which the Canadian Pacific develops?

A. We took the conservative position that if we went to the public on our performance we wouldn't borrow it at 5.95 as we did . . .

THE CHAIRMAN: Would you borrow?

THE WITNESS: No.

MR. FRAWLEY: Q. You couldn't go to the public at all?

A. No.

Q. So that the only realistic way you could do it was just simply to go along on the Canadian Pacific basis?

A. That is right; and that represents a good competitive background which puts us all on the same wicket.

MR. FRAWLEY: Thank you.

THE CHAIRMAN: Mr. Mauro?

MR. MAURO: I have no questions, Mr.Chairman.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

THE CHAIRMAN: Mr. Dickson?

MR. DICKSON: I have no questions, Mr. Chairman.

THE CHAIRMAN: Mr. Doherty?

MR. DOHERTY: No questions, Mr. Chairman.

THE CHAIRMAN: Mr. McDonald?

MR. McDONALD: That is all, Mr. Chairman.

THE CHAIRMAN: Who is your next witness?

MR. McDONALD: Mr. McCoy is the next witness, Mr. Chairman.

THE CHAIRMAN: Perhaps before you call Mr. McCoy we should have a recess.

---Short recess.

(Page 3010 follows)

THE CHAIRMAN: All right, Mr. Doherty.

MR. DOHERTY: Mr. Chairman, might I just make a very brief reference to the evidence that has been led by the C.P.R. and the C.N.R. with respect to the cost of capital, and I have been instructed to say that the government of Saskatchewan adheres to the principles which it advanced before the Board of Transport Commissioners in the rate base rate of return case, and the government of Saskatchewan is unalterably opposed to the use of this calculation in the cost of capital, as proposed by the C.P.R. and the C.N.R., as an element in the determination of the financial needs of the Canadian railways, or the adoption of such requirements in whole or in part as a test of the adequacy of the rate levels or structures.

Now, in this regard, Mr. Chairman, I would like to associate the Province of Saskatchewan with the comments which have been made by Mr. Frawley, and particularly the objections taken by him at the December hearings, and it is our intention to develop this matter further in our later arguments.

MR. FRAWLEY: I believe it is now proposed to call Mr. McCoy, and if I might be allowed to refer to the application which I made this morning, in which I asked leave of the Commission to speak to the motion standing in my name and Mr. Mauro's name at 2:00 o'clock this afternoon, I would now appreciate the Commission giving me the indulgence of allowing me to speak to it tomorrow morning when

the Commission sits again.

THE COMMISSIONER: Yes.

MR. MACDOUGALL: Mr. Chairman and members of the Commission, the next witness to be called by the railways is Mr. Charles Leslie McCoy.

Mr. McCoy is no stranger to you, Mr. Chairman, and to some of the other members of the Commission, having been an employee of the C.N.R. for a considerable number of years, until he severed connections by retiring on the 31st of December, 1959. Mr. McCoy is now retained by the company as a consultant, and I would like to just place on the record his general qualifications.

McCOY, CHARLES LESLIE, called

DIRECT EXAMINATION BY MR. MACDOUGALL:

Q. Mr. McCoy, at the time of your retirement you were Assistant General Freight Traffic Manager, Rates Tariffs and Divisions with system jurisdiction of Canadian National, is that right?

A. Yes.

Q. You were born in the Maritime provinces?

A. Yes.

Q. And you took your early education in the Moncton High School?

A. Yes.

Q. And you joined the Canadian National there in Moncton in 1915?

A. The Canadian Government Railways in 1915, sir.

Q. I believe you started as a messenger

in the Engineering Department and stayed there for a year, and the next year you were promoted secretary to the Assistant Chief Engineer of the Canadian Government Railways at Moncton. In February of 1920 you joined the Traffic Department in a clerical position at Montreal, and worked in various clerical jobs in the Traffic Department, constantly moving up until in 1937 you became Chief Clerk in the General Freight Agent's office at Montreal.

A. Yes.

Q. In 1940 you became Chief Clerk to the General Freight Traffic Manager having system jurisdiction, and in 1945 you were made Assistant General Freight Agent at Montreal?

A. That is right.

Q. In 1948, General Freight Agent?

A. Yes.

Q. And in the early part of 1951, Traffic Manager for the Atlantic Region for Canadian National Railways, headquarters at Moncton?

A. Yes.

Q. And you were then promoted in March of 1952 to Freight Traffic Manager, Rates Tariffs and Divisions at Montreal, and in June of 1955 you were promoted to the position which you held at the time of your retirement?

A. That is right.

Q. Assistant General Freight Traffic Manager, Rates Tariffs and Divisions?

A. Yes.

Q. In the thirty-nine years, Mr. McCoy, that you have been a traffic officer of the C.N.R. you have been particularly interested, I believe, in the rates, freight rates and their applications?

A. Yes.

Q. I believe you appeared before the Board of Transport Commissioners in many cases dealing both with general matters and specific rate cases?

A. That is right, sir.

Q. And I believe you appeared before Royal Commissions?

A. Yes.

Q. And assisted in the preparation of material which has been presented before other Royal Commissions than this present one?

A. That is right.

Q. Did you appear before the recent Royal Commission on the Coastal Trade?

A. Yes.

Q. And I believe also, Mr. McCoy, you have had occasion to lecture to traffic groups interested in transportation and other traffic matters?

A. Yes, I have addressed the Delta Nu Alpha transportation fraternity, both at St. Louis and Tulsa, Oklahoma.

Q. I understand that you have appeared for a number of years as a principal lecturer on transportation and traffic matters before the Staff College operated by the Canadian National at Bishop's University each summer?

A. Yes, on five occasions; on one occasion, I am happy to say, you were the President of the class.

Q. Well, Mr. McCoy, I understand that you had prepared or you prepared yourself or had prepared under your direction a precis of evidence which has been submitted to the Board, and for the parties who are interested in this inquiry it is headed, "A Memorandum in Respect of (a) Statutory and Related Grain Rates in relation to the Freight Rate Structure. (b) Level of Rates for the Movement of Export Grain in Western Canada which would be Just and Reasonable and Reasons therefore."?

A. Yes, the precis of evidence was prepared under my direction.

Q. Are you satisfied, Mr. McCoy, that the information given in that precis is correct and represents a fair statement of the matters contained therein?

A. Yes, I am.

MR. MACDOUGALL: Mr. Chairman, I would like to file with the Commission a copy of Mr. McCoy's precise of evidence as an exhibit.

MR. COOPER: It will be Exhibit No. 79.

--- EXHIBIT NO. 79: Precis of evidence in support of statutory and related grain rates in relation to the freight rate structure.

MR. MACDOUGALL: I have some extra copies here for anyone who hasn't gotten one in the general distribution.

[illegible]

Now, I say for the purposes of the record that we might mark the statements that are attached to Exhibit 79 in the same manner as Mr. Bandeen's testimony was marked, giving each a sub letter, A, B, C, under the general heading of No. 79. Is that suitable?

MR. COOPER: It would be more convenient, perhaps, to just leave it as Exhibit 79, the whole precis. There are identifications of one sort or another on the various statements.

MR. MACDOUGALL: We have numbered the statements attached to Mr. McCoy's testimony for our own internal purposes, and we put exhibit numbers on the pages.

MR. COOPER: If you prefer, Mr. Macdouall, we can mark them the way we did with Mr. Bandeen's.

MR. MACDOUGALL: I would prefer that. Then, the statement NT-100, being the first page attached to Mr. McCoy's precis, being of seven pages, will be marked as exhibit No. 79-A.

---EXHIBIT NO. 79-A: Statement NT-100.

MR. MACDOUGALL: Statement 101, NT-101, being all of three pages, will be marked as Exhibit 79-B.

---EXHIBIT NO. 79-B: Statement NT-101.

MR. MACDOUGALL: Statement NT-102,being of two pages, will be marked as Exhibit No. 79-C.

---EXHIBIT NO. 79-C: Statement NT-102.

MR. MACDOUGALL: Statement NT-103, being of four pages, will be Exhibit 79-D.

---EXHIBIT NO. 79-D: Statement NT-103.

MR. MACDOUGALL: Statement NT-104, being of one page, will be Exhibit 79-E.

---EXHIBIT NO. 79-E: Statement NT-104.

MR. MACDOUGALL: Statement NT-105, of two pages, will be Exhibit 79-F.

---EXHIBIT NO. 79-F: Statement NT-105.

MR. MACDOUGALL: Statement NT-106, consisting of two pages, will be Exhibit 79-G.

---EXHIBIT NO. 79-G: Statement NT-106.

MR. MACDOUGALL: Statement NT-107, the last statement of one page, will be Exhibit No. 79-H.

---EXHIBIT NO. 79-H: Statement NOT-107.

MR. MACDOUGALL: Now, the first three pages of Mr. McCoy's testimony, Mr. Chairman, down to the bottom of page 3, with the exception of the last two lines of Exhibit 79, deals with the explanation of the Board of Transport Commissioners' waybill analysis, and I have brought some extra copies of the 1958 waybill analysis along, but I don't intend to go into the detail of it, but if it was of use to the Commission we would be glad to file the waybill analysis for 1958 as an exhibit. This is a generally known document to most people, but if it is of any use to the Commission we have extra copies.

THE CHAIRMAN: I think that we know it.

MR. MACDOUGALL Q: Now, Mr. McCoy, the first three pages of Exhibit 79, as I have said, refer to a description of the Board of Transport Commissioners' waybill analysis which is prepared annually by that body, and I would ask that we have

those three pages taken into the record to shorten the testimony rather than having Mr. McCoy read it as his testimony in that respect. It starts with, "In the year 1949" and it ends with "statutory and related rates."

In the year 1949 the Board of Transport Commissioners, in order to assemble carload statistics heretofore not available, inaugurated in a series of annual waybill analysis studies. Commencing with the year 1949 annual studies have been made with exception of the year 1950. The last analysis covers the year 1958. This means the Board has published nine reports. During the first four years reports were based on waybills covering carload shipments terminating on four calendar days in each year. It was found, however, that the sampling results of four calendar days did not adequately represent traffic with irregular flow patterns and the Board in 1954 adopted a continuing sampling procedure which is now in effect. Under this procedure the railways participating in the waybill analysis forward photostat copies of every waybill bearing the serial number "1" and serial numbers ending in "01". This study does not include less-carload freight, On Company Service Freight, switching traffic, traffic originating or terminating at rail points outside of Canada, rail-lake-rail, water-rail and ocean-rail traffic.

The railway companies operating in Canada participating in the waybill analysis with percentage of waybills reported for the year 1958 are:

RAILWAYS	% OF WAYBILLS REPORTED FOR USE IN WAYBILL ANALYSIS
Canadian National Railways	51.75
Canadian Pacific Railway (including Quebec Central and Dominion Atlantic Railways)	44.14
Algoma Central and Hudson Bay Railway	0.54
Chesapeake and Ohio Railway	0.56
Great Northern Railway	0.05
Napierville Junction Railway	0.02
New York Central System	0.66
Northern Alberta Railway	1.00
Ontario Northland Railway	1.02
Toronto, Hamilton and Buffalo Railway	0.26
	100.00%

It will be observed that 95.89 per cent of the waybills reported to the Board for use in the waybill analysis were for account of the Canadian National Railways and Canadian Pacific Railway.

Revenues from traffic in the Maritime region have been recorded at the rates paid by the shipper, excluding the amounts paid to the railways in reimbursement for rate reductions made on behalf of shippers under the provisions of the Maritime Freight Rates Act. The revenues from traffic carried between Eastern and Western Canada over the "bridge" territory (Railway Act - Section 468) in Northern Ontario have been adusted to include the total rail revenues. The railways are reimbursed by the Canadian Government for the amounts of the rate reductions required by this Section of the Act. The "bridge" subsidy does not apply to grain and grain products, coal, competitive-rated traffic or agreed charge traffic (Board's General Order No. 833, dated July 3, 1958).

Coal shipments receiving the benefit of Government coal subventions have been recorded at the

total freight revenue received by the railways. The shipper pays the difference between the total freight and the subsidy where applicable. The railways bill the Government for the subsidy amount. The administration of the feed grain subsidies does not involve railway freight waybills or tariffs. In this case the subvention is paid directly to the person who pays the freight charges.

To facilitate examination of the results of this one per cent sample, the statistics are segregated by type of rate, area distribution, commodity, or by combinations thereof. The types of rates shown are class and commodity, with the latter including subdivisions for competitive, non-competitive, statutory and agreed charge rates. The area distribution is recorded through the use of three regions. The Maritime region includes the Provinces of Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland and that portion of the Province of Quebec lying east of Levis and Diamond, Que., south of the St. Lawrence River. The Eastern region extends westward to Port Arthur and Armstrong, Ontario, from Levis, Diamond and Boundary, Quebec. The Western region consists of all lines west of Port Arthur and Armstrong, excluding the Yukon.

The segregation of statistics by commodity is done by separating all carload traffic into five main groups; products of agriculture; animals and products; products of mines; products of forests; and manufactures and miscellaneous. The commodity

grouping is found in Appendix I of Board's Order 90342, dated December 3, 1956 (Canadian Freight Commodity Statistics Classification). Each main group is further subdivided to allow separate tabulation of statistics pertaining to individual commodities moving in volume and for the grouping of the statistics of related commodities which individually do not move in volume sufficient to warrant segregation.

Within the limits of these divisions, the tables in the waybill analysis reports record the number of carloads along with corresponding revenues; weight; ton-miles; average revenue per ton-mile; average haul per ton; car miles and average revenue per car mile.

From these analyses it is possible to extract basic figures which indicate the amount of traffic handled under each of the different categories, that is, traffic moving under class rates, normal commodity rates, competitive rates, agreed charge rates, statutory and related rates.

Q. Mr. McCoy, in that portion of your testimony which is shown on the top of page 2 of Exhibit 79 there is a table there; would you please comment on the number of waybills reported by the two large systems, Canadian National and Canadian Pacific, as they relate to all of the waybills reported to the Board each year from which this analysis is prepared.

Q. The Canadian National in 1958 reported 51.75 per cent of the waybills used in the analysis

and the Canadian Pacific - including the Quebec Central and the Dominion Atlantic - reported 44.14 per cent. That is, the two major railroads in Canada reported 95.89 per cent of all the waybills analysis by the Board.

Q. Now, Mr. McCoy, I understand that the amount of revenue which the railway company receives from the different segments of its traffic varies widely, is that correct?

A. Yes, that is so.

Q. Well then, as a traffic officer interested in this aspect of the railway's operations, how can you measure these various segments of revenue to decide whether you are satisfied that each is returning its proper contribution to the overall revenues?

A. The relative merit of the revenues earned by different segments of traffic can be measured by four different yardsticks, two of which are directly available in the waybill analysis reports; i.e., revenue per ton-mile and revenue per car mile. The other two yardsticks which can be calculated from statistics in the waybill analysis reports are the average amount of revenue per ton and the average amount of revenue per carload. Unless they are properly related to the length of haul, they should not be used for general comparison purposes. The average revenue per car mile which takes into account the length of haul does not indicate directly the weight of the payload carried. Only the revenue

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

per ton-mile reflects the relationship of revenue earned to length of haul and weight. Furthermore, the revenue per ton-mile yardstick is free from the complications that arise when comparison is made of the revenue results of competing modes of transportation or of rolling stock with different physical load capacity. For instance, the comparison of the revenue results of dry traffic moving in 120,000 pound capacity box cars against, say, those of gasoline moving in full tank-car capacity 64,000 pound shipments could not be adequately made solely on the basis of revenue per car mile statistics. In other words, of all these four yardsticks, only the revenue per ton-mile has the common denominator quality of describing the relative merit of revenue results without regard to the mode of transport or to the physical capacity characteristics of rolling stock.

Q. In speaking of this factor of revenue per ton mile, as you just have, would you be so good as to refer to paragraph 34 of the joint submission of the Canadian National and Canadian Pacific, which was filed as Exhibit 45, wherein this included a table, and give us your comment on that table.

A. The purpose of this table is to illustrate that the average revenue per ton-mile has risen during this period for all traffic excepting the agreed charge and the statutory and related rated traffic. The seeming decrease in the revenue per ton-mile of the agreed charge traffic can be accounted for by the substantial increase in

its average length of haul, the greater variety of commodities covered by agreed charges and also by the necessity of meeting market competition from foreign sources, particularly on the west coast.

(Page 3022 follows)

In all rail rate scales the rates for different lengths of haul are not uniformly increased. The scales taper in favour of longer hauls, thus reflecting the distribution of relatively high terminal costs over longer distances and minimizing transportation charges on long haul movement.

Consequently, when average revenues per ton-mile are examined, they must be considered along with lengths of haul.

Q. Now, Mr. McCoy, are you referring to paragraph 34 of the joint submission of the two railways, Exhibit 45, the heading there entitled: "Average Length of Haul (miles)" for each type of traffic. Would you please explain the use of this term?

A. The average length of haul (miles) used in that table is calculated by dividing the car miles produced by all the traffic in the group by the number of cars in the group. The average length of haul can also be calculated from correspo nding ton-miles statistics. The results describe the amount of transportation without regard to the car mileage required. Such average length of haul statistics are shown in the Waybill Analysis reports. The revenue per ton mile information with corresponding average length of haul in terms of the commodity movements as reported in the Waybill Analysis reports are as shown in Statement NT102, which has been filed as Exhibit No. 79-C, I think.

Q. Now, Mr. McCoy, would you please then compare the length of haul used in your Statement, which

is Exhibit 79-C, which you have just spoken of, and that shown in paragraph 34 of the Joint Submission? I notice that in Exhibit 79-C you have "Average haul per ton", and in the paragraph 34 of the Joint Submission it is "Average length of haul (miles)"?

A. A comparison of these two tables shows the differences reflecting the effect of using different bases for calculating length of haul. However, the revenue relationships are not disturbed and both tables show that the traffic moving at statutory and related rates has not assumed any share of the increased costs since 1949. Its revenue per ton mile has not increased during the last ten years, while that of the other traffic has borne substantial increases.

This is substantiated in the following table which shows the length of haul per ton and average revenue per ton mile for all traffic excluding grain and grain products moving in Western Canada to export positions during the years 1951 to 1958, as calculated from statistics in Waybill Analysis reports, along with corresponding statistics for the grain and grain products traffic.

Q. Thereafter, Mr. McCoy, follows a table on page 6 of Exhibit 79, which I would ask, Mr. Chairman, to be taken into the record at this point.

THE CHAIRMAN: Very well.

MR. MACDOUGALL: Page 6.

[illegible]

[illegible]

[illegible]

[illegible]

Year	All Traffic Excluding Grain & Grain Products: Average Haul per ton Miles	Revenue per Ton-Mile ¢	Grain and Grain Products: Average Haul per ton Miles	Revenue per Ton-Mile ¢
1951 (January, April & July)	342	1.60	758	0.53
1951 (October)	284	1.62	770	0.53
1952	312	1.86	888	0.49
1953	297	2.20	867	0.51
1954	312	2.01	805	0.53
1955 March 1 to Dec. 31)	330	1.83	799	0.53
1956	340	1.96	869	0.49
1957	350	2.09	859	0.49
1958	341	2.09	852	0.50

MR. MACDOUGALL: Q. Now, Mr. McCoy, in respect to that table that I have just spoken of, would you care to make anyu comments in respect of it?

A. The table does not list 1949 results as the Waybill Analysis of that year did not segregate the statistics for traffic moving at statutory and related rates. This makes it impossible for us to calculate for that year the average revenue per ton-mile for all traffic excluding the grain and grain products traffic.

It is interesting to note that while the average lengths of haul have not changed materially over the years, the revenue per ton-mile relationship of the grain and non-grain traffic has changed from a ratio

of one to three to one to four, thus reflecting the failure on the part of the grain traffic to absorb increased operating costs.

Q. Where, Mr. McCoy, in that table do you see these figures which substantiate that last part of your testimony in the change of ratio from one to three to one to four?

A. Well, sir, in the year 1951 all traffic, excluding grain and grain products, was 1.6 cents, and in the column at the extreme right it is 0.53 cents, that is about one-third.

Q. That is the column for grain and grain products?

A. Yes; and in 1958 the revenue per ton-mile is 2.09 cents for all traffic excluding grain and grain products, as compared with the 1.6 cents I have mentioned. Now, the grain products, the revenue per ton mile is .50; in other words, about one-quarter of the 2.09 cents revenue.

Q. Also, Mr. McCoy, in that table I notice for the year 1953 that the revenue per ton-mile for all traffic excluding grain and grain products seems to have taken a substantial increase from 1.86 in 1952 to 2.20 cents in 1953. Is there any explanation for that?

A. Yes. The average revenue per ton-mile for the traffic excluding grain and grain products for the year 1953 rose substantially over that of 1952, following the two general freight rate increases authorized by the Board of Transport Commissioners

effective January 1st and March 16th, 1953. During the last five years the railways have encountered increased competition and had to establish more competitive rates which have depressed the average revenues per ton-mile below the level attained in 1953. However, the 1958 average revenue of 2.09¢ per ton-mile of all traffic, excluding grain and grain products moving in Western Canada to export positions, is 30 per cent greater than that of 1951 while the average revenue per ton-mile earned in the handling of this grain and grain products traffic has not changed. However, as the statutory and related rates are kept at a constant level and as increased competition necessitates the establishment of many additional competitive rates, the railways find it difficult to improve their overall average revenue per ton-mile without attempting to place on the non-competitive traffic the burden of increased operating costs.

MR. MACDOUGALL: At this point, Mr. Chairman, in the precis there is reference to page 33 of the Joint Submission.

THE CHAIRMAN: It is in the record already.

MR. MACDOUGALL: Yes, the reference being made to the freight rates case in 1956, 76 C.R.T.C. 53 at page 91.

Q. Mr. McCoy, looking at your statement NT-102, Exhibit 79-C, it shows the average revenue per ton-mile and corresponding length of haul of commodity movements reported in nine Waybill Analysis reports by rate category, and it indicates that the average length per ton-mile has risen during the period 1949

[illegible]

to 1958 for all traffic except agreed charges and statutory and related traffic. Would you please tell the Commission if you are aware of the reason for this seeming decrease in the average length per ton-mile for agreed charge traffic as shown in that statement which you will note under "Agreed Charges" has increased from 94 to 348, whereas the revenue per ton-mile has decreased from 3.20 to 2.47?

A. Well, as I said earlier, in respect to the table in paragraph 34 of the Joint Submission, which is Exhibit 45, the seeming decrease in the revenue per ton-mile for the Agreed Charge traffic can be accounted for by (1) the substantial increase in average length of haul, which is shown clearly on Statement NT-102; and (2) the greater variety of commodities covered by Agreed Charges in 1958 as compared with earlier years; also (3) by the necessity of meeting market competition from foreign sources, particularly on the west coast.

Q. The factor of increased average length of haul which you speak of as the first of these three factors is explained by this Exhibit 79-C, but do you have any other factors?

A. Yes. The greater variety of commodities covered by Agreed Charges is explained in Statement 79-A. This statement, you will observe, shows that there were 17 commodity items covered by Agreed Charges as of December 31st, 1949, whereas there were 362 commodity items covered by Agreed Charges at the end of 1958.

Q. That is the Statement NT-100, now Exhibit 79-A, that you have referred to?

A. Yes. Then if you will look at Statement NT-101, which is now Exhibit 79-B, you will see Commodities, their origins and destinations, covered by Agreed Charges in effect at the end of 1958 and entered into because of market competition from foreign sources. Therefore these two statements, NT-100 and NT-101, support the statement NT-102, in respect of the reasons for the decrease in the revenue per ton-mile on Agreed Charge traffic over the period 1949 to 1958.

Q. Is there anything you wish to add in respect to that aspect of Exhibit 79-C, Mr. McCoy?

A. No, sir, no further comments on that.

Q. In respect to the first part of your testimony set out in your precis of evidence, Exhibit 79, that is the first eight pages, is there anything further you wish to comment on or tell the Commission about?

A. No, sir, not at this point.

Q. Then if you will turn to the second portion of your precis of evidence in Exhibit 79, which deals with the level of rates for the movement of export grain in Western Canada which would be just and reasonable and reasons therefor, I see that there you refer to Statement NT-103, which is now Exhibit 79-D. Could you tell us what that statement shows?

A. Exhibit 79-D, entitled "Statement Showing Production in the Years 1953 to 1957 inclusive,

of grain in Manitoba, Saskatchewan and Alberta-British Columbia and amounts handled by the Canadian National, Canadian Pacific and Northern Alberta Railways for the crop years 1953-1954 to 1957-1958 inclusive", has been prepared to show the extent of the participation of the Canadian National, Canadian Pacific and Northern Alberta Railways in the transportation of the major grain crops in Western Canada, namely, wheat, oats, barley, rye and flaxseed.

It is evident from the figures shown that in some crop years, notably 1956-1957, there was apparently a considerable carryover of grain which would be reflected in rail handlings. For example, in that crop year only 44.4 per cent of the production was handled by rail. The percentage figure I have just mentioned is found on line 12, page 4 of the exhibit.

Q. Under the column on the right-hand side entitled "Total Rail Handlings, % of Production"?

A. That is correct.

Q. Now, Mr. McCoy ---

THE CHAIRMAN: Does this apply to all grain moved, domestic and otherwise, or only that moved on statutory rates?

THE WITNESS: It is my understanding, sir, that it covers the entire movement.

THE CHAIRMAN: Domestic and ---

THE WITNESS: Domestic and to export positions. Of course, you will appreciate that the greater percentage of the traffic would be for export.

MR. MACDOUGALL: Q. Mr. McCoy, perhaps

[illegible]

you would be good enough to look at page 4 of the exhibit. At the bottom of the page there is a note there. Perhaps you could speak to that, if you please?

A. The note reads: "Production figures represent gross production estimates by Dominion Bureau of Statistics for a calendar year. Handling figures by railways represent shipments occurring in a crop year, i.e. August 1st to July 31st, from Western Country Elevators", and the source of the information is Grain Trade of Canada -- Agriculture Division -- Crops Section of Dominion Bureau of Statistics.

Q. Page 4 of this Exhibit, Mr. McCoy, is a summary of the other three pages; is that right?

A. Yes. That is the total for the three provinces added together, or the four provinces added together.

Q. And it shows the total production?

A. On the third column from the left, that is right.

Q. And the handlings by the three railways are similarly set out for each year by bushel and the total on the right-hand side?

A. Yes. Perhaps I should further state that the exhibit does not include grain from Canadian Government interior semi-public elevators located at Lethbridge, Edmonton, Calgary, Moose Jaw and Saskatoon, grain loaded over platforms, shipments of Canadian and U.S. grain at private terminals and mill elevators in Western Division. Nor does it contain shipments of Canadian grain from semi-public terminal elevator at

North Transcona.

Q. Would these shipments from these points which you have spoken of be a large or small portion of the total handlings?

A. No, sir, it would be only a very small portion of the total. To illustrate, in the crop year 1957-1958 it only approximated about eleven million bushels of wheat, oats, barley, rye and flaxseed. In fact, the wheat movement was only 6,101,000 bushels in the crop year mentioned.

Q. Am I correct, Mr. McCoy, that this information is tendered for general information, or have you some particular reason that you wish to ---

A. It is a matter of general information, sir.

Q. Now, Mr. McCoy, have you anything further you wish to say with respect to Exhibit 79-D?

A. No, sir. I think that covers the story as far as we are concerned at this time.

Q. Well, then, sir, would you refer to your next statement in your precis, NT-104, which is Exhibit 79-E?

A. This exhibit was prepared to indicate the extent of general increases that have been accorded since 1927 in the rates on grain moving within Western United States. It shows the effective date in each case and the amount of the increase, also the reference to Interstate Commerce Commission reports in each case. It will be observed that the cumulative increase shown at the bottom of the page is 106.6 per cent.

Q. And that applied to the rates on grain in western United States subsequent to 1927?

A. Yes, sir, to points such as Duluth and Seattle.

Q. That, I take it, also, Mr. McCoy, is given for general information as to the situation in the bordering states of the United States?

A. Yes, sir.

Q. Perhaps in that regard, Mr. McCoy, you would just read for the record the note at the bottom of

[illegible]

Exhibit 79-E?

A. The statement does not show particulars of compensating adjustments which took place between 1927 and March 27, 1938. These adjustments were not of general application but of specific nature.

However, the changes cancelled out each other, and thus prompt the use of this table for comparative purposes.

To further elaborate the note, it is my recollection that as a result of the Oakes-Smith resolution of the United States proceedings dealing with grain rates in the western United States were covered by ICC docket 17,000, Part 7.

Q. What is the number again, Mr. McCoy?

A. Docket 17,000, Part 7.

Q. Now, Mr. McCoy, can you give us any information as to the relationship between the Crows Nest grain rates and the applicable class rates on grain?

A. At the time, rates on grain and grain products were established, on September 1, 1899, on the Crows Nest level in compliance with the provisions of the Crows Nest agreement, these commodities were rated 8th Class in the Canadian Freight Rates Classification and remained on this rating until March 1, 1955. On the latter date, a uniform scale of Class Rates and a new Canadian Classification became operative, authorized by the Board of Transport Commissioners under its Order No. 83242, dated March 1, 1954, and Order No. 85386, dated January 19, 1955. Grain and its products were rated in the new Canadian Freight Rate Classification at column 30 or 30 per

cent of column 100, which is the equivalent of the previous rating of 8th Class.

On September 1, 1899, the Crows Nest level of commodity rates to Fort William reflected approximately 40 per cent of the 8th Class standard mileage class rates. When the statutory rates on grain became wholly operative on September 12, 1927, the relationship of the commodity rates to the 8th class rates dropped from approximately 40 per cent in 1899 to approximately 32 per cent. This changed situation resulted from the implementation of various adjustments in the class rate structure between September 1, 1914, (Western Rates Case -- General Order 125, dated May 30, 1914-17, C.R.C. 123) and December 1, 1921 (General Order No. 350, dated November 24, 1921 -- 11 J.O.R. & R. 255), which brought about an overall increase in the general level of class rates, while the level of the commodity rates on grain moving to export positions on September 12, 1927, remained at the 1899 level or lower.

The July 31, 1959 relationship of the Crows Nest grain rates to the applicable Class 30 (or 8th Class) rates to Fort William, Ontario, ranged from 12.6 per cent at Edmonton, Alberta, to 15.6 per cent at Winnipeg, Manitoba.

Q. That Edmonton rate is a paper rate, Mr. McCoy, I suppose?

A. Well, I'm sorry, I cannot answer that right now, but if it is a paper rate, I cannot under-

stand why the Alberta Wheat Pool owns or bought the Manitoba Pool Elevator No. 9, known as Union. It is still operated by the Manitoba Pool at Port Arthur. You maybe know more about that.

Q. Oh, no. You would know all about it.

A. No, I don't know all about it.

Q. I thought the western grain moved to the west coast?

A. I'm afraid that is not altogether correct.

Q. If anything moves on it it is not a paper rate -- if anything moves on it at all?

A. No, sir, it is not.

Perhaps, Mr. Frawley, the bulk of the grain which moves to Port Arthur may not necessarily be for export overseas. The bulk may be for movement west. I don't know about that.

Q. Now, Mr. McCoy, perhaps you would direct your attention to Statement NT-105, which is Exhibit 79-F, which is headed, "Statement showing statutory and class rate relationship on grain and grain products at various origins to Fort William, Ontario."

Would you please explain the purpose of this statement, Mr. McCoy?

A. This statement was prepared to show the relationship of the present statutory rates and standard mileage class rates in effect on September 12, 1927, and the class rates applicable on July 31, 1959 to Fort William, Ontario, from various origins.

It will be noted in column B various

[illegible]

[illegible]

Q. Oh, no. [illegible]

A. No, I don't [illegible]

Q. I thought [illegible]

this meant [illegible]

A. I'm afraid [illegible]

truth.

Q. [illegible]

[illegible]

A. No, [illegible]

[illegible]

Q. Now, Dr. [illegible]

[illegible]

Now, [illegible]

[illegible]

Q. [illegible]

[illegible]

representative origins are shown. Column C shows the 8th class standard mileage rate in effect on September 12, 1927. Column D shows similar information for each origin on the basis of Class 30, as in effect on July 31st, 1959.

Q. Well, Mr. McCoy, what is the purpose or the significance of the dates, July 31, 1959, column G?

A. Following July 31st, 1959, the special $20 million subsidy was put into effect, and thus the rates in effect on that date are the basis on which the railway's revenue is determined.

Q. I see. Perhaps I interrupted you. You had explained, I think, the column D. Will you go on and explain the rest of the exhibit, Mr. McCoy?

A. Column A shows statutory grain rates for the various origins. In columns F and G are general percentage calculations showing percentages which the statutory rate is of the 8th class standard mileage rate in effect September 12, 1927, and also the Class 30 rate in effect July 31, 1959.

Column H shows the rate which would be in effect if the 1927 percentage ratio were applied to current class rates. As an example, taking line 4 for the short line rail distance of 419.1 miles, the statutory rate to Fort William is 14 cents per 100 pounds. Percentage ratio to that rate to September 12, 1927, 8th Class rate is 31.1 per cent and by applying this percentage ratio to the July 31, 1959, Class 30 or 8th Class rate of 90 cents, the rate

becomes 28 cents per 100 pounds, or an increase of 100 per cent over the present statutory rate.

On page 2 of the exhibit, Edmonton, Alberta appears on line 30 at mileage 1227.3. The percentage the present statutory rate of 26 cents bears to the 1927 8th Class rate is 32.1 per cent. The application of this latter percentage ratio to the July 31, 1959, class 30 rate results in a rate of 66 cents per 100 pounds, or an increase of 153.8 per cent over the present statutory rate.

Column "I" shows the percentage relationship of the rates in Column H to the statutory rates in Column E. It will be noted that they vary from 100 per cent for the short hauls to in excess of 150 per cent for the longer hauls, with intermediate hauls showing fairly consistent upward progression.

Q. Mr. McCoy, Mr. Frawley has pointed out those places in Alberta, such as Edmonton and Evansburg and Yates, are a considerable distance from Fort William, and I suppose it is fair to assume that some, if not the bulk of the grain exported, would go to the west coast, rather than to Fort William?

A. I think that is right. As a matter of fact, I understand the dividing line is somewhere between the Alberta-Saskatchewan border, on export traffic.

Of course, the Canadian National does not go into Swift Current, so I shouldn't say that.

THE CHAIRMAN: But, a line north from there?

THE WITNESS: Yes.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

MR. MACDOUGALL: Q. In any event, Mr. McCoy, your purpose in submitting this exhibit is to show the calculations contained therein and the percentage factor which would result from it, which is in your last column?

A. Yes, sir.

Q. What about the Regina rate of line 20? Would you care to comment on that one?

Perhaps you could just give us the result of the similar calculation in Regina?

A. Well, at Regina, the percentage of the statutory rate on September 12, 1927, was 31.7. July 31, it was 14 per cent. Now, if the 1927 percentage ratio were applied to the current Class rates, the rate would be 45 cents or an increase of 125 per cent over the present statutory rate of 20 cents.

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-

-

Q. Well, Mr. McCoy, have you anything further that you wish to say with respect to the relationship between statutory and applicable class rates?

A. Yes; as I previously mentioned the commodity rates in effect in 1899 reflected approximately forty per cent of the then applicable 8th class and of the mileage rates, and this relationship could be used as a basis for the construction of a proposed level of rate at this time.

However, in view of the fact that the present prescribed level of the statutory rates was not operative from all points of shipment, both eastbound and westbound, until September 12, 1927, it is considered their relationship to the 8th class and the mileage rates prevailing at that time is more realistic as a measure of reasonableness than reverting to the 1899 percentage relationship. This position is supported by the fact that the changes directed by Parliament in 1925 - The Railway Act - now R.S.C. 1952, Chapter 234, Section 328(6) -- and additional adjustments subsequently ordered in 1927 by the Board of Transport Commissions by General Order 448, dated August 26, 1927, were all in effect.

Q. What would be the effect of an adjustment in these class rates that is shown in column H of Exhibit 79-F?

A. Well, this method of rate adjustment,

if followed to a conclusion, would seriously distort the existing rate pattern, and it is our view that, as the geographical centre of the grain-producing area now lies in Saskatchewan, an accceptable fee rate could be the Regina-Soo-Fort William commodity rate, presently 20 cents per 100 lbs., for a haul via the Canadian National Railways of 791 miles, which is close to the average haul of this traffic to the Lakehead of 814 miles in 1958.

The distance of 814 miles mentioned in paragraph 9, page 4 of the Canadian National brief---

Q. This brief of Canadian National is, I believe, Exhibit 46?

A. Yes, Exhibit 46.

The difference of 814 miles mentioned there is the average haul in 1958 on grain to the Lakehead. The average hauls in 1958 on grain and grain products to the Lakehead, as well as to other export positions are as follows:

	Miles
Lakehead	824
Armstrong, Ont.	837
Churchill, Man.	920
Vancouver, B.C.	1021
New Westminster, B.C.	991
Victoria, B.C.	1110
Prince Rupert, B.C.	1044
Average Haul Total Traffic	885

On Exhibit 79-F ---

THE CHAIRMAN: I wonder if we had better adjourn until tomorrow?

MR. MACDOUGALL: Perhaps he might read

another six lines and he will have completed his answer to the question.

THE CHAIRMAN: Yes.

THE WITNESS: On Exhibit 79-F Regina appears at mileage 790.1, which is the distance via Canadian National Railways from Regina to Fort William. The present rate from Regina is 20 cents per 100 lbs., or 31.7 per cent of the September 12, 1927, 8th class rate. Applying this percentage to the July 31, 1959, column 30 rate would produce a rate of 45 cents, or 125 per cent over the present statutory rate.

This, of course, is confirmed in line 20, page 2 of the exhibit.

Q. That is the point I asked you about earlier.

A. That is correct.

THE CHAIRMAN: We will adjourn until 10:00 o'clock tomorrow morning.

---Whereupon the hearing adjourned at 4:05 p.m.
to resumt at 10:00 a.m., Tuesday, January 19th, 1960.

ROYAL COMMISSION

ON

TRANSPORTATION

HEARINGS

HELD AT

OTTAWA

VOLUME No.: 22

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INDEX TO EVIDENCE AND EXHIBITS

EXHIBITS

ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 19th day of January, 1960

COMMISSION

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Mr. A. H. Balch	Member
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Mr. G. S. Cumming

Mr. H. W. Ellicott - Adviser

Mr. F. W. Anderson	Secretary
Major N. Lafrance	Assistant Secretary

ERRATA

Page	Line	
3082	23	Change "responsibilities" to "expenses".
3083	8	Change "freight" to "rate"
3096	9	Change "one" to "some"
3099	18	Change "corroboration" to "collaboration"
	22	Change "corroboration" to "collaboration"
3102	13	Change "the right of selling" to "put our ceiling"
3144	28	Change "international power" to "instrument of national policy"
3145	7	Change "Mauro" to "McCoy"
	14	Change "hold" to "work"
3149	27	Change "185" to "85"
3152	25	Change "557.7" to "577.7"
	28	Change "Rosebud" to "Rouses Point"
3153	6	Change "mines" to "lines"
	22	Change "lovely" to "public"
3154	5	Change "Fort Edward" to "Point Edward"
3165	26	After "receiver" change "unloaded" to "loaded"
3176	14	Change "competitive" to "captive"
3185	13	Change "545" to "54-55"
		Change "or the" to "there are"
	14	After figures 582,754, delete semicolon (;)

Page	Line	
3114	7	Change "on" to "or"
3120	27	Change "line" to "mile"
3123	1	Change "4.9" to ".49";
		Change "4.93" to ".53"
3124	11	Change "rate" to "revenue"
3132	9	Change "out" to "about"
3134	10	Change "series" to "Sections"
3143	16	Delete "when we look" insert "we are looking"
	17	Change "report" to "rates"
3144	4	After "Western" insert "U.S."
		Change "Canadian Cities" to "Kansas City"
	5	Change "Canadian" to "gulf"
	7	Change "thank you" to "doubt"
	8	Change "from places" to "through ports"
3152	26	Change "newspaper" to "news print"
	27	After "three" insert "paper"
3154	11	After "through" insert "rates"
3155	10	Change "and of" to "other than"
3156	5	Between "average" and "class" insert "haul on";
		Change "rate" to "rated traffic"

Page	Line	
3156	7	Change "a difference" to "the difference"
	10	Change "work" to "haul"
	12	Change "on" to "of"
	14	After "related" insert "rates"; After "Class" insert "rates"
3163	23	Change "competitional" to "competitive conditions"
		After "and we try to change" and "with"
3166	6	Change "rates" to "cost"
3172	8	Change "be" to "include"
3175	21	Change "the" to "to"
	27	After "domestic" insert "and"
		After "export" add "to Fort William"
3176	19	Change "mentioned the" to "many"
		Change "rate" to "rates"
3189	19	Change "33" to "30"
	26	Change "33" to "30"
3191	11	Change "group" to "rule"
3210	13	Change "56" to "36"
3372	16	"Likely" should be "definitely"

Page	Line	
3210	18	Change "Frawley" to "Bell"
3283	9	"Settlement" should be "Supplement"
	11	"Brief" should be "Proof"
3292	14	Eliminate words "over the use of" and substitute "east of"
3362	11 and 15	"at" should be "on"
	18	"comparative" should be "competitive"
3371	7th last line	"Altoona" should be "Altona"

REVISIONS OF WITNESSES

3080	19	Change "responsibilities" to "expenses"
3081	15	Change figures "202 to "29.9"
3083	9	Change "Edmonton" to "Montreal"
3085	14	Change "truck" to "car"
3086	12	Change "for" to "from"
3090	13	Delete "wheat"
3096	1	Change "in" to "to"
3097	19	Change "prepared" to "Increased"
3099	6	Insert after "wheat"; "if we had" change "and" to "on"
	15	Insert after "your" "competitive"
3103	6	Change "being precise where" to "present when"
3113	15	Insert "is necessary" after "action"

	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]

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[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]

Ottawa, Ontario,
Tuesday,
January 19, 1960

---On commencing at 10.00 a.m.

THE CHAIRMAN: All right, gentlemen, will you come to order, please?

Yes, Mr. Frawley.

MR. FRAWLEY: Before the cross-examination of Mr. McCoy proceeds, Mr. Chairman, I would like to speak to the motion which is in my name and Mr.Mauro's name.

I first of all want to say that we appreciate your standing it over from yesterday until today to suit our convenience.

Now, I want to say no more at the moment than to indicate what the nature of the motion is and to ask for a date to be fixed for the hearing of it and for the hearing of evidence to support it.

This is a motion which arises out of the conference which we had with the railways last week, and at that time we put certain requests to the railways and they were declined. We thought -- that is by-the-by now -- but we thought that we could possibly appear informally at the Commission with railway counsel and state our position at that time. However, the Commission directed that we should be more formal about it.

THE CHAIRMAN: There are two sides to it that should be argued.

MR. FRAWLEY: That is right. What I am

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

saying is that I thought we could have gone in informally to the Commission at that time. But that is a small circumstance. We have served our notice. That has merit itself, probably.

Now, then, we come before the Commission, therefore, to request the Commission to direct the furnishing of the information which the railway declines to furnish.

THE CHAIRMAN: I take it from what you say that there will be, of course, the leading of evidence?

MR. FRAWLEY: Yes. I said I would say very little except to ask to fix a time, and perhaps I don't have to say anything more.

THE CHAIRMAN: I think that we would want to know what form your evidence would likely take, and also from the railways, whether they will be calling any evidence and the time it would take.

MR. FRAWLEY: Yes; the other point is the date on which we would tender the evidence, and the time that it will take.

THE CHAIRMAN: Well, Mr. Frawley, might it not be better, and save discussion this morning, if you and Mr. Sinclair talked this over and discussed the time and the number of witnesses and the date and spoke to it tomorrow morning?

MR. FRAWLEY: That is perfectly satisfactory.

THE CHAIRMAN: Would that be all right with you, Mr. Sinclair?

MR. SINCLAIR: Yes, Mr. Chairman. But before that is done, the motion as it is made -- and I

take it, now, officially, in view of my friend's remarks, that it is before the Commission -- is not at all clear to me, and I wonder if my friend would assist by telling me what he means when he talks about commodity groups? What does he mean by that?

MR. FRAWLEY: Well, as a matter of fact, there certainly isn't any secret about that. I took that language from the last copy that I have of the ICC Burden Study which is Statement 6-58 of November 1958. There is a later one.

I took the language from the description of this document -- from its own description. It is described as "Distribution of the railroad revenue contribution by commodity groups." Now, if that isn't clear to my friend I am just afraid that I will have to ask somebody else. I am not saying he shouldn't have the information . . .

MR. SINCLAIR: I think it would assist. I am sure that is what we all want to do. I want to know if my friend, by virtue of the remarks he has just made, means by "commodity groups" in the motion he makes the commodity groups as set up by the Interstate Commerce Commission?

MR. FRAWLEY: Well, I would think the Canadian freight structure would have such groups. We have our own setup.

MR. MAURO: On this, since I have joined with Mr. Frawley in this motion, I think it might facilitate matters and save the time, possibly, of the Commission, if these sort of questions were addressed to the experts

that Mr. Frawley and I have approached to advise us in this matter.

We, obviously, are going to try and base this on the Canadian situation, but I am very sympathetic towards Mr. Sinclair's desire to have placed before the Commission just exactly what is intended by this proposed cost study, but I suggest also that perhaps Mr. Frawley and I are not the people best able to answer technical questions such as that, and that they might be directed to those people whom we will call in support of our motion when the date has been fixed.

THE CHAIRMAN: I understand from Mr. Mann that the Canadian and the American are the same.

COMMISSIONER MANN: They are pretty well identical.

MR. SINCLAIR: Well, Mr. Chairman, in the ICC there are a number of groupings. There is one grouping that is called 272 Commodity Groups. I take it from what my friend Mr. Frawley said that that is not what they want, and that is not what they meant by "commodity groups." I also know . . .

MR.FRAWLEY: I am in no position to admit what my friend says at all.

THE CHAIRMAN: Well, you can see the tangents we are getting into in the discussion here.

I would suggest that on Thursday morning you could give us the date, but that you should try to iron out what the motion means and what you have in mind.

MR. FRAWLEY: There is always a great need,

for our own sake as well as for the Commission's, to make as much haste as possible because of the commitments of the witnesses.

THE CHAIRMAN: I quite realize that, but we might not get as much haste by going fast.

MR. FRAWLEY: I am entirely in accord with your suggestion. You suggest that Mr. Mauro and I and possibly Mr. Stechisin sit down with Mr. Sinclair?

THE CHAIRMAN: And possibly with the good offices of Mr. Cooper.

MR. SINCLAIR: Mr. Chairman, I do think that my friend could say that, because if we are going to do so we should know. Is he looking for the five major commodity groups as set out in the commodity breakdown?

MR. FRAWLEY: The answer is No.

MR. SINCLAIR: The answer to that is No?

MR. FRAWLEY: The people who seem to know tell me that; but, frankly . . .

MR. SINCLAIR: Is it the 264 commodity groups that are set out in the breakdown?

This, of course, means quite a bit. One is five and the other is 254.

MR. FRAWLEY: Well, I will discuss all that with . . .

THE CHAIRMAN: I would suggest that you try to work it out and report back to us.

MR. SINCLAIR: Very well, then, Mr. Chairman.

May I go to another point in the light of this motion? I think that we should be told whether this motion and the information requested by Mr. Frawley means

[illegible]

that it is in lieu of -- and that he has withdrawn -- the motion that he spoke to on December 4th before this Commission, and which is reported in Volume 10 and, in particular, the delineation of that motion -- he starts at page 1213 and the delineation of the motion is at page 1219?

THE CHAIRMAN: I don't know whether Mr.Frawley is prepared to say at this time . . . ?

MR. FRAWLEY: In fact, I don't think it would be fair for me to even possibly compromise my position.

We made clear our position when we were at the informal conference. Commission counsel knows that.

If our friend means us -- and when he says "Mr. Frawley" I would like him to add "Mr. Mauro" -- if he means us to put an admission on the record which will be, perhaps, a trap for us down the road in maybe a couple of months -- I don't know, that just comes to my mind . . .

MR. SINCLAIR: I am sure I have no design, or would attempt to trap anybody. I am only interested in trying to find out what Mr. Frawley wants.

MR. FRAWLEY: It is suggested by the Commission that it would save time to sit down with you and discuss it.

THE CHAIRMAN: I think, Mr. Frawley, that motion of yours, which was not in writing, was supported by a letter which was in writing.

MR. FRAWLEY: That is so.

THE CHAIRMAN: Are we to assume that this motion which you now propose to bring is in place . . .

MR. FRAWLEY: Yes.

THE CHAIRMAN: . . . of that letter?

MR. FRAWLEY: Yes, that is exactly right; I can go that far.

While we are discussing those things -- and I can be brief about this -- I also asked for another set of data at the informal conference, and that was to enable our consultant that we have retained for the purpose of working up a submission on the whole question of horizontal percentage increases -- we put in a request which came from that consultant to the informal conference last week; and we put it in in the way of wanting a copy of Railway Form A for system freight operations for the years 1950 and 1958, to segregate costs which are related to length of haul from those unrelated to length of haul. Now, that was refused, and so, after discussion with Commission counsel, it was agreed that I need not go the length of the formality of serving a separate notice of motion but that if I wrote a letter to my friends, Mr. Sinclair and Mr. McDonald, that would suffice to put it on record before the Commission, and I have handed a copy of this letter to Mr. Anderson; and, possibly, for the record and for later reference I might read that letter into today's transcript.

I sent identical letters to Mr. Sinclair and to Mr. McDonald, except for the obvious substitution of "Canadian Pacific" in one letter and "Canadian National" in the other letter.

I would read the letter to Mr. Sinclair.

[illegible]

It is dated January 18th, 1960, to I. D. Sinclair, Esq., Chateau Laurier Hotel, Ottawa, Ontario. It reads:

"Dear Mr. Sinclair:

Re: Royal Commission on Transportation

"At the first opportunity available, I propose to request the Commission to direct that the Canadian Pacific Railway furnish me with a copy of Rail Form A for system freight operations for the years 1950 and 1958 to segregate costs which are related to length of haul from those unrelated to length of haul.

"This data is required by my consultant and necessary for his analysis of Horizontal Percentage increases and the preparation of a submission upon that subject to the Commission.

"Yours very truly,

"J. J. Frawley."

Copies to Mr. Anderson, Secretary, Royal Commission on Transportation.

The same letter was written to Mr. McDonald, and, of course, I referred to Canadian National in the body of my letter rather than to Canadian Pacific.

That information having been refused, I would like the Commission to direct that that information be furnished.

Whether or not this matter can be dealt with by the people who come to discuss the matter which is taken care of in the Notice of Motion, I am not

[illegible]

too clear. It is a narrower question.

I would prefer to have it on a document. My consultant tells me that he cannot make any progress at all unless he is able to separate out the on-the-road costs, as he calls them in his correspondence with me, and the terminal costs which are sometimes referred to as costs relating to length of haul as against costs unrelated to length of haul.

(Page 3054 follows)

Now, as to that, sir, I don't propose to call any witnesses to substantiate the request which I make, but simply put it to the Commission that my consultant can't do the work he proposed to do on horizontal percentage increases without this information. Whether it comes in the form of Rail Form A or not, I am not primarily and essentially concerned.

If the segregation of the costs related to length of haul and those not related to length of haul can be segregated out and supplied to the Commission and my consultant for the preparation of a complete Rail Form A first, I will accept that.

Now, if the railways are not directed to do that, then I think I should say now that I cannot pursue it any further and I will leave this question of horizontal percentage increases in which I have had almost a proprietory interest for many years.

I would have to just withdraw somewhat reluctantly, because I would like to take part in what I think will be the final and, I hope, effective statement on this question, but speaking for myself, I would bow out and I would leave this whole question, then, of horizontal percentage increases with the Commission, and its staff, and they can take my consultant and take it from there.

On the other hand, if you are concerned with my preparing it at the expense of the Province of Alberta, I will be glad to do it, but I can't do it without this data.

we can't give him what he has asked for. It is not available.

Now, I was happy to know that it was to be at his expense, because I take it from that he is saying to the Commission and through the Commission to the railways that the cost of preparing any data for the work that he wants to do will be at the expense of Alberta.

Now, this is a point which we think is proper and reasonable; if it is available it takes money to produce it and it is not necessary for the railways' submissions to the Commission, in our opinion, not necessarily for the assistance of the Commission, and I can be wrong and Mr. Frawley can be right, but we are very glad to see that he has taken note of the fact that there are expenses involved and he is accepting on behalf of Alberta that expense provided there is some method of developing this information which he wants.

THE CHAIRMAN: You mean you are taking from that the railway's expense, or his own expense?

MR. SINCLAIR: Of course, that would be the normal result as I heard him express it, and in view of matters we have discussed at other places and at other times because, Mr. Chairman, I am reminded of this; in this matter of expense, the railways prepared freight classifications and there was a time when it used to be given out by the railways for a nominal amount. The railways said, "we have a freight classification and we are required to do certain things

[illegible]

with it, but we are not required to do other things with it, so that anybody that wants it will pay for it," and while somebody raised their eyebrows because the railways have been looked upon as some type of an eleemosynary institution by certain of those people for sometime, after a while they realized what the railways had been putting forward was quite a correct point, and what they have been putting forth for quite some time, and we never hear anything about it any more, they do it as a matter of course.

I do know when this matter was first suggested to my friend, Mr. Frawley, he was a little nonplussed when he asked the railways about this that it would have to be at the expense of the person requesting it, and I am glad to interpret it - I think this is the right interpretation - that he has seen our position in this regard was eminently reasonable, and on that basis we can maybe take a look at it.

THE CHAIRMAN: But the time is of some consequence to the Commission and, Mr. Sinclair, how long will it take to produce the information required? You refer to works, not time.

MR. SINCLAIR: I say that the way Mr. Frawley has put it, it cannot be got; just as short and quick as that. Not available. Physically not possible of reproduction.

MR. FRAWLEY: Why all the silly talk I am doing for that, then?

MR. SINCLAIR: Then I said that may be we

could work out something else. Now, I don't know; may be we could, but to work out something else - and if it was available to us, whether we could give it to him or not - it would take time, and then giving it to him would also take time, and that means money, and I was glad to hear what he had to say in that regard, and if he wants us to go forward in that regard, we will take a look and just drop them an account.

MR. FRAWLEY: Of course ---

THE CHAIRMAN: I think there is some preliminary work that Mr. Sinclair and Mr. Frawley can do with Mr. Mauro.

MR. MAURO: I am not involved in this.

MR. SINCLAIR: It is Mr. Frawley of and by himself.

THE CHAIRMAN: Pardon?

MR. SINCLAIR: Mr. Frawley of and by himself.

MR. DOHERTY: I would like to speak to the Commission. Mr. Frawley and Mr. Mauro have made a motion for the statement showing the distribution of the rail revenue contribution by commodity groups. We in Saskatchewan think it is a necessary study, and I would like to associate myself with Mr. Mauro and Mr. Frawley in the request before the Commission for the information requested.

MR. SINCLAIR: This is the first motion?

MR. DOHERTY: Yes. Insofar as the

second motion of Mr. Frawley's is concerned, for the preparation of Form A, and in which Mr. Frawley's experts are making a study of the horizontal increases, I wish also to associate myself with Mr. Frawley's proposal. However, I have this proposed difference - I think Mr. Frawley mentioned it - now we think, perhaps, it is a study that should be undertaken by the Commission, but apart from that the study is necessary and I would like to associate myself with Mr. Frawley's request, but on the basis that this be undertaken by the Commission.

MR. MAURO: Just so that it is clear, in dealing with your statement, Mr. Chairman, that Mr. Sinclair should not be exposed to both Mr. Frawley and I on this particular subject simply because Manitoba has not retained any experts specifically on horizontal percentage increases, but we are making a submission on it and although from our end of it we don't require to the best of our knowledge the type of information that Mr. Frawley's experts have advised him they require, but we do support Mr. Frawley's application and his right to request this information and receive it in order that he can place this information before you.

THE CHAIRMAN: I think we have taken up enough time of the Commission this morning on this so far as the record is concerned, and if Mr. Sinclair and Mr. Frawley and Mr. Mauro and Mr. Doherty now are in the picture as well, we will speak to this and Mr. Cooper will be glad to act as

a mediator, and if you can report back tomorrow morning or Thursday morning, we will try to hear you.

MR. SINCLAIR: We have spent three days on things like this, and I would suggest that Mr. Frawley had better just go forward with this, because I think it is a waste of time to talk any longer because unless he has something specific to ask in the light of what we have said about what is available, then there is no use us talking at all.

THE CHAIRMAN: Well, in any event, Mr. Sinclair, I think it is important to know what has been called in support of the motion when it is ---

MR. SINCLAIR: This is the first motion?

THE CHAIRMAN: Yes.

MR. SINCLAIR: I am talking about the second one.

THE CHAIRMAN: I think so far as the second motion is concerned we will take it that we have the situation in hand, but so far as the first motion is concerned we want to know how much time is needed, what evidence is being called by Mr. Frawley and by the railways, and you have made your position clear.

MR. SINCLAIR: I haven't spoken to the first motion at all, sir.

THE CHAIRMAN: No, the second.

MR. SINCLAIR: Yes, but on the first one I have a great deal to say about it at the appropriate time.

THE CHAIRMAN: I know it is the second.

MR. SINCLAIR: The second is the one I have

been speaking on.

THE CHAIRMAN: And speaking of the second, Mr. McDonald hasn't said anything, but did I understand that the Canadian National couldn't under any circumstances do the Form A?

MR. McDONALD: No, we haven't got the records, and I understand from what Mr. Frawley said this morning it is the terminal costs there on the rate costs, and in our accounts those are not segregated, and we can't give that.

MR. FRAWLEY: To elaborate on that to some extent, the central idea is the segregation of the cost related to the length of haul from those not related to length of haul. That is the beginning and the end of the information which this man wants.

Now, I sent him a great mass of material, everything I could get from D.B.S. and the Board of Transport Commissioners, everything I could think of, and he said, "I am sorry, it is not there." In the I.C.C., of course, it is right there jumping right up at you, and he has done a study in which he was able to segregate just precisely that, he was able to compare the increase between 1950 and 1958 in the costs related to length of haul as against the increase in those two years of the costs not related.

Now, it is there in the I.C.C.; these are problems we have had many times before, but it does seem to me that we could look at the methodology in the I.C.C. which produced the figures ----

[illegible]

THE CHAIRMAN: Do you know what I.C.C. material he did use?

MR. FRAWLEY: Well yes, it is clear he referred to certain statements, and I am very sorry, I should have had his correspondence here, but I have had to take up so much time, but I can give you a good resume. I did more than that, I referred to Mr. Banks, my consultant in Washington, to check with other information and with other consultants, and Mr. Banks gave it considerable thought and when he was here last week he translated that request and said, "Give us the Rail Form A and that will disclose the segregation of the costs related to length of haul as against those not related to the length of haul." All I say about Rail Form A or not is,if it can be obtained any other way, then I would be satisfied.

(Page 3066 follows)

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[illegible]

[illegible]

[illegible]

THE CHAIRMAN: Would the ICC documents or information correspond in any way to what the Board of Transport Commissioners would have?

MR. FRAWLEY: I would certainly think so. I am sure that when Mr. Banks put that request he wasn't asking for something that he thought was impossible to obtain, because when we come back to Form A I am prepared to say that the Canadian Pacific has and have produced Form A in the past.

MR. SINCLAIR: That is wrong.

MR. FRAWLEY: I am making the statement that in 1952 they produced a cost study of coal moving from Alberta to Ontario which, if it wasn't a Rail Form A, was a modification of Rail Form A.

THE CHAIRMAN: Gentlemen, we can get into this wrangle and get no place, so I am going to rule now that this matter is going to be adjourned till tomorrow morning or Thursday morning, whichever suits parties best, and then parties can get together on the first motion, and then we will have the second motion.

MR. SINCLAIR: I wish to say this, to make this abundantly clear, that, notwithstanding whatever Mr. Banks may or may not have said -- and I am not prepared to discuss what he said because we were having an off-the-record chat -- I think the Commission should know that under the ICC reporting as required of railways there is a separation between terminal and line haul. There is no separation under the basis of the compiling and making statistics in the reports prepared by the railways of Canada.

[illegible]

MR. MACDOUGALL: I would add to that, to emphasize that point, that the ability in the ICC to separate the line haul and terminal cost is based upon the historical data which is prepared just in that form, and our position is that our data is not prepared in that form. If we did that we would be in the same position as the American roads where they did that some years ago.

THE CHAIRMAN: Does this go back to the old valuation of the United States roads many years ago?

MR. MACDOUGALL: As Mr. Sinclair points out, there are many special studies behind this.

THE CHAIRMAN: In any event, I think we can close off. Will we leave it till tomorrow morning or Thursday morning?

MR. FRAWLEY: Whatever you say, sir.

THE CHAIRMAN: Thursday morning. Mr. Macdougall?

MR. MACDOUGALL: Mr. Chairman, when we adjourned yesterday afternoon Mr. McCoy was on the stand.

CHARLES LESLIE McCOY, recalled

DIRECT EXAMINATION BY MR. MACDOUGALL (Cont'd):

Q. Mr.McCoy, yesterday you had told us of the effect of making rate adjustments as portrayed in your statement NT-105, which was filed as Exhibit 79-F, and you described there certain distortions which you thought would result but which you felt might be mitigated by the use of an acceptable key rate. Now, could you tell us what the effect would be of this conclusion of using a key rate which you spoke of in respect of traffic, grain traffic, moving from prairie points to the west coast of Canada and at Churchill?

A. The present rates on grain from Prairie points to British Columbia Pacific Coast ports for export were established effective September 12, 1927, (Board's General Order No. 448, dated August 26, 1927) and to Churchill,Manitoba, for export effective August 20, 1931, on the same general basis as the rates to Fort William. Any percentage adjustment authorized in the statutory rates on grain to Fort William should be applied uniformly to all ports of export.

Q. I see. Now, if you will turn to Statement NT-106, Exhibit 79-G. Could you give us some information as to the comparison of the statutory rates on grain in Canada and those in existence in the United States on grain?

A. This exhibit shows that the present United States rates applying from twenty origins in

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[illegible]

[illegible]

[illegible]

States adjacent to Western Canadian Prairies range from 27½ to 78½ cents per 100 pounds higher to Duluth, Minnesota, than the present Canadian statutory rates in Western Canada for corresponding distances to Fort William.

Q. In that statement, Mr. McCoy, you have taken comparable points in Canada and in the Western United States of equal mileage or approximate mileage and compared the rates. Is that the purpose of that statement?

A. Yes, sir, that is correct.

Q. Perhaps you would be good enough to point out for the record a couple of comparative points on this Exhibit 79-G?

A. Take Regina, Saskatchewan, as representative, line 11. The distance to Fort William is 776 miles, the rate 20 cents per 100 pounds. From Whately, Montana, a distance from Duluth of 772 miles, the rate is 72½ cents, a difference of 52½ cents per 100 pounds. Line 23, from Edmonton, Alberta, to Fort William, a distance of 1228 miles, the rate is 26 cents; from Fortine, Montana, a distance of 1229 miles, the rate is $1.04½ cents per 100 pounds, a difference of 78½ cents.

On page 2 we have rates to Vancouver and Seattle. From Alberta, Saskatchewan, Montana points, and taking Edmonton as a base, Line 29, a distance to Vancouver of 765 miles, the rate is 20 cents; from Shelby, Montana, a distance of 756 miles, the rate is 81 cents, a difference of 61 cents per 100 pounds.

Line 37, Saskatoon, Saskatchewan, 1088 miles, the rate is 24 cents; to Seattle, Washington, from Poplar, Montana, 1085 miles, the rate is 94 cents, or a spread of 70 cents per 100 pounds.

Q. Mr. McCoy, what conclusions would you draw from this Exhibit 79-G?

A. Well, the statement shows the level of rates that would be applicable today -- I am sorry, sir, I have the wrong exhibit there.

Q. It is NT-106 that you have just been speaking to?

A. Yes. It is recognized that the level of United States rates is not used as a firm guide for establishing rates in Canada. Nevertheless the substantial differences between the statutory rates in Canada and the United States rates shown in Statement NT-106, or Exhibit 79-G, confirm the reasonableness of the Canadian National submission that the rates on grain and grain products to export positions remain under statutory control and the railways be reimbursed for the cost of the work performed in handling this traffic by means of a payment made to them equal to the difference between the statutory rate and the amount found to be a just and reasonable level of return.

Q. Than is this another test or check that you have sought and applied to the general principle that your company is proposing to this Commission?

A. Yes, sir.

Q. Have you anything further to say in

respect of NT-106?

A. No, sir, not in respect to that exhibit.

Q. If you look at the next statement, NT-107, which is Exhibit 79-H, have you any explanations to give the Commission concerning that statement?

A. This exhibit shows the level of rates that would be applicable today if the rates in effect on September 13, 1920, to the lakehead, their highest level since implementation of the Crow's Nest Agreement in 1899, had been subjected to all increases or reductions authorized subsequent to that date. I might add that you will note that the statement shows the rates from Winnipeg, Brandon, Regina, Moose Jaw, Saskatoon, Calgary and Edmonton.

Line 14 shows what the rate would be from these points in 1958 if the general rate increases or reductions had been applied. You will also note that the Winnipeg rate would be 44 cents, compared with the statutory rate of 14 cents; the Regina rate would have been 74 cents, as compared with the statutory rate of 20 cents, and the Edmonton rate would have been 95 cents, as compared with the statutory rate of 26 cents.

Q. Have you anything further you wish to say in respect of that exhibit 79-H?

A. No, sir, not in respect of that particular exhibit.

Q. Based upon the evidence which you have been giving to the Commission, Mr. McCoy, and the information contained in these exhibits which you have been explaining and speaking to, have you any general

comment on this whole subject which you wish to leave with the Commission?

A. In 1958 the movement of grain and grain products handled at statutory and related rates on the Western Region of the Canadian National Railways produced approximately $28.7 million ---

THE CHAIRMAN: 28.6 or 28.7?

MR. MACDOUGALL: That is a correction that was made in Mr. Bandeen's evidence.

THE WITNESS: --- or 17 per cent of the total revenue earned on this Region. Slightly over 40 per cent of the work on the Western Region was performed to earn this grain revenue.

Also this traffic produced only 6 per cent of the total Canadian National (Canadian Lines) revenue, but required 19 per cent of the total freight transportation service.

These statistics are mentioned to stress the importance of the economic problem faced by Canadian National in handling this grain traffic. As indicated in Section VIII of the Canadian National Submission, Exhibit 46, paragraph 7, page 3, as will be shown in evidence, an increase of -- and here is a further correction -- 123 per cent in revenue would cover Canadian National's total costs. Consequently, we have submitted the information on rates past and presently applicable in Canada and in the United States along with an indication of the level that established rate-making principles would suggest, in order to assist the Commission to determine what would be a

just and reasonable level of compensation.

Q. Now, Mr. McCoy, you have come to the end of the precis of evidence which was prepared under your direction. Have you anything further you wish to offer to the Commission at this time?

A. No, sir, I think that fairly well summarizes the submission.

Q. Well, sir, would you be good enough to answer any questions which may be put to you by the Commission or by my learned friends in the provinces and other interests?

A. Yes, sir.

THE CHAIRMAN: Mr. Cooper?

(Page 3080 follows)

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[illegible]

[illegible]

[illegible]

Q. Mr. McCoy, I refer you to Exhibit 45 which is the joint submission of the two railways, to page 11.

A. Yes, sir, I have it here.

Q. You refer to national policy as reflected in the statutory grain rates and then state in the second sentence:

"These things arise by reason of the distortions in the rate structure caused by the inflexibility in the grain rates."

That is the quotation.

What are the distortions in the rate structure to which this part of the joint submission has reference?

A. Yes, sir. The distortions as we see them are the facts that the rates cannot themselves be changed. In other words, we cannot move them either up or down. We could move them down, of course, I should say, but we cannot move them up as conditions change or as our responsibilities change. In other words they are frozen. And, to the best of my knowledge I do not know of any other rates in the entire country that are frozen.

Q. Well, Mr. McCoy, by that sentence are you relating the words "the distortions in the rate structure" solely to grain rates? I understood the sentence to mean that the inflexibility in the grain rates caused distortions in other rates. Am I correct in that or not?

A. Well, I don't know as I thoroughly

understand your question; I'm sorry.

Q. The grain rates are fixed; they are statutory?

A. That's correct.

Q. As a result of the grain rates being fixed; being statutory; are there distortions caused elsewhere in the rate structure?

A. To the extent that you are not allowed to increase your rates as conditions or times change, it brings about the impossibility of getting adequate revenue on grain traffic. When I say adequate revenue, I mean compensatory revenue. In other words, sir, Mr. Frawley filed an exhibit through Mr. Edsforth, and there is one that I filed, in the last revenue case. We had an increase in all other freight traffic of $202 million; on grain statutory rates, no increase whatever.

In other words, the picture clearly indicated that grain was not bearing its fair share or any share whatever of our increased outlay. This is a revenue case forced upon the railways due to increased cost.

Q. Do I understand you to mean by that sentence, Mr. McCoy, that the words the "distortions in the rate structure" refer to the grain rates and grain rates only?

A. Yes, sir.

MR. MACDOUGALL: I think it must be remembered that the submission you are referring is the joint submission of the two railways submitted by their counsel.

MR. COOPER: Yes. It is a statement in the joint submission, and I would just like to understand it.

THE WITNESS: In other words, sir, if you are operating a normal commercial firm and you have one segment of your business frozen at the 1899 level, you soon get out of it, I think, because, as an ordinary business man that would certainly distort your picture.

I am not talking about the railway getting out of the grain business. Don't misunderstand me. As an ordinary business man, I don't see how any business organization could operate on an 1899 level of prices.

Q. In your view, is this the only distortion in the rate structure?

A. I wouldn't say the rate structure is perfect all over Canada. There are certain other distortions. For example -- and this may sound rather strange coming from me -- but there is a distortion in the rate structure in the Maritime freight rates. And, in fact, the Maritimes rates have always been distorted because they have never reflected to the Maritimes themselves the normal mileage schedule.

Q. What other distortions in your opinion are there in the freight structure?

A. I could talk about a week and probably take one after the other in distortions. But our picture today has certainly changed a lot because of competition.

Q. Perhaps you could mention the principal distortions you consider there are in the freight rate structure besides the grain rate structure you have referred to?

A. The word "distortions" is a rather misleading one. If you were talking about a rigid mile -- mile progression -- you could get into a host of them. You have a freight from Montreal to Vancouver that is lower than from Edmonton to Calgary or Saskatoon.

Q. You regard that as a distortion?

A. It is not a distortion in one sense, but we are acting as business men and we are allowed to meet the competitive situation from off-shore traffic. By off-shore traffic, I mean exports from Japan or the United Kingdom or Europe. But the word "distortion", as I take it, in some cases is that many people feel the railways should have a rigid progression in the rates as distance increases or, perhaps, in some cases not be allowed to increase their rates except to a maximum amount. But that is a policy. You could lead me into a large field there a long way from transportation, because I felt for years that there was too much manipulation in prices through the medium of freight rates.

Q. Have you any other experience of distortions, Mr. McCoy, without going into any great length, that you would like to give?

A. Not offhand, no, sir, but there is no doubt we could find some if we went looking. But

I wouldn't say the word "distortion" was the correct word, either.

Q. What word would you use?

A. Departure from rigid rate patterns. When I say rigid rate patterns, I mean rates based solely on mileage. In other words, sir, while a ton-mile is one meausre, you cannot get always into the same ton-mile earning on a competitive rate where you are meeting water competition and perhaps market competition. Then, you get a normal rule of thumb rate.

Q. On page 13 of the joint submission, paragraph 35, you referred to the average haul on agreed charge traffic as having increased, indicating the greater distances at which other forms of transportation are able to compete successfuly with the railways for this traffic, plus the necessity of meeting foreign market competition.

Am I correct in understanding that when you use the words "other forms of transportation", which are used in this joint submission, they refer particularly to motor truck competition?

A. I would say largely motor truck competition, but in addition to that, of course, you always have water competition.

Q. Trucks are increasing their range; I think you would agree with that?

A. Yes, sir. There is no question about that.

Q. At what distance can trucks now compete

successfully with rail, Mr. McCoy?

A. That is a question which is rather difficult for me to answer because I am not in the trucking business. I do not know to what extent they can compete with us, but what they do is they seem to be able to compete even as far as from Vancouver to Montreal, and I have heard of truck movement as far east as from Vancouver to Halifax.

There is no doubt about it. Truck competition is on a trans-continental basis today.

We put an agreed charge in on petroleum products in western Canada effective last September, and my recollection is the maximum distance was about 900 miles. That is for tank truck movement -- in competition with tank wagon movements.

Q. About 900 miles?

A. Yes, about 900 miles is my recollection. It may be slightly higher than that.

Q. Thank you, Mr. McCoy.

Does the distance of truck movements with which the railway has to compete increase in any relationship to increases in freight rates by the railways?

A. Yes, sir. As you lift your umberella, naturally your competitor can get a better crack at you. In other words, the higher your level is forced through circumstances beyond the railway's control the more it is exposed to competition.

Q. You refer also in that paragraph, or at least in that paragraph 35 of the joint

[illegible]

submission, to competition from foreign sources. Competition from foreign sources is referred to and the words are used, "meeting market competition from foreign sources, particularly on the Pacific coast".

The "foreign sources" in question -- do they include the United States?

A. In certain cases, yes, sir -- particularly products produced in California, Oregon, Washington.

In other words, there is a highly competitive market both for off-shore, as well as from United States origins.

Q. On page 5 of your precis, Mr. McCoy, Exhibit 79, you state that at the end of 1958, 362 commodity items were covered by agreed charges. Could you tell us whether or not that figure of 362 has increased since the end of 1958, or decreased, or what is the situation now?

A. Well, sir, we have had a year's experience since then, and off hand I would say it has increased -- perhaps materially increased. We are, as you probably realize, increasing our output of agreed charges. In fact, we are having particularly good success with industry in lining up with us. I do not say that we are perhaps too generous in some of the rates we give, but it is a contractual basis and it is working out very satisfactorily. We find in some cases where we get an agreed charge with 75 per cent or 80 per cent

participation promises, we perhaps go up to 85 per cent or 90 per cent.

Q. What are the upper or lower limits in the degrees which the shippers must use the railways for shipments under agreed charges?

A. Well, our natural object is 100 per cent. We are not successful in that, of course, in many cases, but we endeavour to adhere to 75 per cent as the minimum.

Now, we have one agreed charge which produces considerable traffic for us. The minimum is 55 per cent, but there is a corresponding agreed charge with a 75 per cent minimum.

On the other hand, the 55 per cent minimum has rates slightly higher than the 75 per cent minimum requirement.

Frankly, when you get below 75 per cent, we wonder sometimes if this is worthwhile making an agreed charge, unless you can get an increased rate.

Q. What is your experience with fixed charges -- people coming on the agreed charge contract and having fixed charges.

A. We have had varying experiences on that. In fact, we had one not so long ago where the company didn't want to come into the agreed charge because they didn't get the same publicity as their competitor.

But, generally speaking, sir, we find that after an agreed charge is issued competitors usually come in.

I give you the other case more or less in the humorous vein, more than anything else, to indicate to you how

Q. I refer, Mr. McCoy, to paragraph 7 of the Exhibit 46. That is the submission of the Canadian National Railways with respect to the level of rates for the movement of export grain in western Canada. Paragraph 7.

I just want to make sure with you that the changes have been made there in the figures necessitated by Mr. Bandeen's corrections.

What figures have you there, Mr. McCoy, for paragraph 7?

A. On the sixth line it reads with total cost shown to be 58.8 million. I have the figure 63.9 million.

Q. You have 63.9 million?

A. Yes, sir.

Q. Yes?

A. And the next line, 28.7 million, in lieu of 28.6, and an increase of 123 per cent in lieu of 105 per cent.

Q. As I recall it, that figure 105 was not changed as a result of Mr. Bandeen's evidence, but I think you agree that it should be changed and should now appear as 123 per cent?

A. Yes, sir, I would agree with that.

Q. In paragraph 8 of Exhibit 46 it is assumed that the statutory rates were just and reasonable on September 12th, 1927. What is the basis of that assumption, Mr. McCoy?

A. The reason for that statement is, perhaps, you could say, that the rates settled down to a certain extent flowing from the Board's general order No. 448.

Q. That was in 1927?

A. Yes, effective August 26th, the rates becoming effective September 12th. The situtation levelled itself out on Parliament telling us what to do.

Q. The basis for the assumption is the action of Parliament in telling the railways what they had to do?

A. The Board's General Order flowed from the action of Parliament.

Q. Coupled with the Board's General Order No. 448?

A. Which covered rates to Vancouver and Prince Rupert.

THE CHAIRMAN: We will recess for five minutes.

---Short recess.

Q. Mr. McCoy, would you turn to the precis of evidence, Exhibit 79, page 11? In the third complete paragraph on that page Edmonton, Alberta, is mentioned as Mileage 1227.3. There was some question arose yesterday as to whether there were any movements

of grain from Edmonton to the lakehead, and I did not understand, or appreciate, perhaps, the answer to that question. Would you mind telling us whether or not there is movement of grain from Edmonton to the lakehead?

A. Yes, we have a few representative shipments; but the point I made yesterday was not the traffic itself but rather that I have been advised that the Alberta Wheat Pool owns Manitoba Wheat Pool Elevator No. 9, which is at Port Arthur. On the other hand, I understand it is still operated by the Manitoba Pool. The traffic movement I have today did not pass through that particular elevator; that movement was handled by wheat train through Armstrong, Ontario, to the port of Halifax.

Perhaps I can come back to that in a moment or so; I can't lay my fingers on the movement right now.

I might say that they are not necessarily from Edmonton. I have one here. This is from Lethbridge on the C.P.R. to Halifax, hauled by the C.N.R. from Saint John to Halifax.

We have another from Rosebud, Alberta, again to West Saint John.

THE CHAIRMAN: That will be for what?

THE WITNESS: It is export.

MR. COOPER: Q. Will you tell us how significant these movements are?

A. No; unfortunately I never made a study of that. But I would understand this is sacked grain which is usually used for topping off the vessel's load. You know how they usually top it off with sacks to keep it from shifting when it is on the water.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q. Mr. McCoy, you have your mileage scale on existing Crow's Nest rates. Are those the commodity rates covered by each different rate, broken down by mileage?

A. Yes, we have that information. It is not what you might call a mileage scale. It is something like Topsy. It simply grew.

Q. I wonder if we could have a copy of that filed as an exhibit?

A. Yes, we could do that; and I think if you also had a map showing, in different colours, the rates to the lakehead from the various origins in the west it would be helpful.

MR. MACDOUGALL: We will supply that.

MR. COOPER: It will be Exhibit 80, I believe. When the document comes in we will give it an exhibit number.

Q. In your precis of evidence and submission of Canadian National dealing with the level of rates for the movement of export grain in western Canada, which would be just and reasonable, you adopt, as the basis of a revised rate, the 1927 Regina key rate, and mention a relationship of 32 per cent at that time to the corresponding class rate. Am I correct in my understanding that commodity rates are not always related, percentagewise, to their corresponding class rates?

A. That is correct; and that applies particularly to competitive rates. On the other hand, there are many commodity rates related to class rates; and, furthermore, many commodity rates actually represent

class rates; not in the classification itself, but, perhaps, some lower rate. It couldn't be higher; it must be lower.

What I have in mind is, let us assume you have a commodity which corresponds to classification 45, or column 45. You might find that your normal 45 rate would not permit the free movement, and after going into the subject with shippers and reviewing it you might get down to Class 35 or 33. I would hope that you wouldn't go to Class 27, which, unfortunately, they sometimes have to do. But, generally speaking, it is a tidier job if you can tie your normal commodity rate to the class rate.

Q. But you can't . . .

A. Not always.

Q. . . . do that?

A. No, not always.

Q. So that there are various commodity rates, Mr. McCoy, do I understand, which are not related percentagewise to their corresponding class rates?

A. That is absolutely correct.

Q. I wish to refer you to Exhibit 79, and particularly to Statement NT-106, which is 79-G.

Taking those movements to Duluth, Minnesota, the first three movements there from York, North Dakota, Carrington and Stanley -- the rates are 46 per cent, 42½ per cent, and 44½ per cent. Do you know if those are normal commodity rates, or if those rates are competitive rates?

A. To the best of my knowledge they are

normal commodity rates.

I know that there are competitive rates within what we call the western trunk line territory.

It is my recollection that the United States railways brought about a competitive adjustment about a year ago, but I have not got the dates of the changes.

To the best of my knowledge, these are normal rates.

MR. COOPER: Thank you, Mr. McCoy.

CROSS-EXAMINATION BY MR. MAURO:

Q. Mr. McCoy, do you feel that the Waybill Analysis has been helpful to parties interested in transportation matters?

A. Yes, I think it has been helpful. In fact, I know it has been helpful to me at times; and sometimes it even misguided me. I will admit that, too; particularly the original analysis where you had the four days' traffic.

THE CHAIRMAN: The four days on the original wasn't very well spaced?

THE WITNESS: That is correct; and, as a matter of fact, in setting up our movements, in many cases the traffic didn't move on the days we selected; particularly on the larger movements.

THE CHAIRMAN: But today's is intended to cover . . .

THE WITNESS: It is a one per cent sample now.

MR. MAURO: Q. Under the present one per cent sample it is a helpful and informative document?

A. Yes.

Q. In your opinion, would further information be of considerable assistance to both railways and shippers and other interested parties?

A. Well, you are leading me into a large field there. Certainly, the more information we have the better off we would be. But, on the other hand, on the trying problem, for railway freight traffic officers, of the existing freight rates it is hard to find out exactly what is needed. I remember getting some awful weird proposals put up. If I had adopted half of the rate proposals submitted to me I wouldn't have had my job as long as I did.

MR. MACDOUGALL: You are not suggesting, are you, that you had to get out at the end?

THE WITNESS: No; I just had enough.

But, in any event, trying to be helpful to you, there is a field which we consider has been neglected, and that is that the railways have been subjected to requests for an awful lot of information. Now, how long can they go on giving out information -- all their secrets, so to speak -- and industry keeps everything closely guarded and covered up is a situation from which I could visualize nothing but trouble in the future.

MR. MAURO: Q. Well, do you think if the Waybill Analysis contained this information which you point out is not presently contained, such as less than carload freight, on-company service freight, switching traffic, traffic originating or terminating at railway points outside of Canada, rail-lake-rail, water-rail and ocean-rail traffic -- do you think that they might

be proper subjects to be included in a waybill analysis?

A. I wonder if you would let me see that list?

Q. It appears on page 1 of Exhibit 79. It is your list. The quotation, in its proper context, is . . .

A. Less than carload freight was tried on one occasion by the Board and the railways. It was a tremendous task, and whether or not we got any benefit out of it I can't say. But it would be a tremendous task.

So far as the on-company service freight is concerned, I don't know if that would add anything or not. How that would help, I don't know. Switching traffic, that might be of help.

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[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

The traffic in the rail points outside of Canada, the international traffic, that could be of some assistance, but there you are up against the problem of what proportion, what do the railways get out of it, the Canadian railways? You would have to have a further breakdown of that, but I don't really know what it would add.

Rail-lake-rail, water-rail, ocean-rail traffic, that would be of one use, sir, but the international traffic I don't see what help that would be, because after all our rates on international movements are usually influenced by the level of the United States.

Q. Yet it represents a rather important proportion of the freight traffic of both the Canadian National and the Canadian Pacific?

A. Yes, it certainly does.

Q. And when one would be trying to consider the balance and distribution with international traffic, it would be an important aspect to consider?

A. It is an important segment of our traffic, there is no question about that, sir.

Q. I think you have before you now the exhibit in the 17 per cent case?

A. Yes. That is the Canadian National exhibit?

Q. Yes, and in reply to my learned friend, Mr. Cooper, concerning distortions, you pointed out in the 17 per cent case grain and grain

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

products moving in statutory and related rates took no part of the increase?

A. That is right.

Q. And that that was in your opinion a distortion. You also told the Commission of the increase which international traffic took in the 17 per cent case.

A. Excuse me, in the 17 per cent case there was no increase, but that is only part of the story and I would like to give you the entire story.

The mathematical increase on international rates was 154 per cent. Now, the average yields for all the United States, which would include international traffic, is 112.1 per cent, and the mathematical increase in Canada was 157.3 per cent, but the estimated yield of the Canadian National on intra Canadian traffic was only 86.1 per cent. In other words, the international rates were treated not in this application, no, there is no question about that; they were prepared prior to this.

Q. As far as any distortion in the structure that might result from the 17 per cent case and the fact that I said wheat and related grain was not going to take any part of it, I suggest, Mr. McCoy, that as far as that 17 per cent was concerned, international traffic was going to take no part of the increase, either?

A. There is no question about that, but the exhibit says the United States increases apply; in other words, you already applied the increase.

Q. What about agreed charges; what part of that 17 per cent were the agreed charges going to take?

A. The agreed charges were - we have an estimated yield of 313,500 a year, .8 per cent.

Now, to the best of my knowledge, Mr. Mauro, neither the Canadian National nor the Canadian Pacific have had the opportunity of putting a dollar valuation on what has actually transpired since the 17 per cent increase was awarded to railways. I can assure, however, that we have been moving in the direction of getting every possible cent we can in the way of an increase.

Q. I certainly want to make this very clear, as it has been clear in the statement that you quoted at page 7 of your precis from the judgement in the 15 per cent case, that there are factors in the rate structure itself which are largely responsible for the situation in which the railways now find themselves, Mr. McCoy, and I am not placing any blame ---

A. Oh no.

Q. --- on the railways, but I just feel that it probably is a very important aspect of this Commission inquiry that we be very clear and honest when we say that from the many distortions in the Canadian freight rate structure, that the distortions have, in fact, resulted in inequities, and that it is the task of this Commission, for whatever assistance all of us can give them, to try and see if there is some solution. Would you agree with that?

A. Well, perhaps the distortions wouldn't

be as pronounced had we been able to move our freight rate structure - our entire freight rate structure - as conditions changed.

In other words, as our expenses increased perhaps we wouldn't have had this particularly large distortion on wheat increases and Crow grain rates, and I think the exhibit which was filed yesterday morning indicates that the railways have increases in their agreed charges to a great extent.

Mark you, transport conditions change and we have to change with them, and in many cases when you start out for an increase in an agreed charge - I shouldn't say many - in some cases where you start out you may end up getting less money because of the change in your situation, but that doesn't say that the rates on the agreed charges are not compensatory.

THE CHAIRMAN Q: Mr. McCoy, just on the agreed charges, to what extent is there corroboration between the two railways in trying to get increases or ---

A. I would say there is very close corroboration.

Q. Very close?

A. Yes. I know that Mr. Edsforth, Mr. Roberts and myself have had many meetings - and Mr. Miller also, we have had many meetings.

Q. Both for new ones and getting increases?

A. Yes.

MR. MAURO Q: Under the Maritime Freight

Rates Act, Mr. McCoy, as I understand it you received reimbursement from the federal treasury for not only the reductions in the non competitive and class rates but also for reductions in competitive rates and even on agreed charges?

A. Yes, but once you reduce your rate below the normal level your compensation decreases - I mean, from the federal government.

Q But it still remains thirty or twenty per cent?

A. That still remains the percentage, but the dollar content in itself changes, naturally.

Q Only we who have taken the horizontal percentage increases on the one side can fully realize that every time there is a difference of a percentage increase, you certainly increase the charge factor, and when you reduce rates the actual dollars paid by the federal government drops, but my point is that to the extent that you are receiving compensation for reductions on competitive and agreed charges, this is really an assist to the railways and not to the shipper because the ---

A. The level wouldn't be the same to start with if it were not for the Maritime freight rates adjustment.

Q. That is a distortion?

A. That is rather, I would say, a cruel word.

Q. I didn't use it, I think you used it in reply to Mr. Cooper.

A. Mr. Cooper used the word first, of course.

Q. He comes from the Maritimes, and we will permit him ---

A. I have that honour as well, sir.

MR. SINCLAIR: I think Mr. McDonald pointed out that lawyers sometimes use words, and maybe we will have to have them explained as to what is meant when the time comes.

THE WITNESS: But frankly, as far as recapture is concerned under the Maritime Freight Rates Act, we received a percentage recapture under the agreed charges and the competitive rates as well as the normal rates. However, we think there are very few normal rates in the Maritime provinces, as I understand normal rates.

MR. MAURO Q: My point, Mr. McCoy, is that you wouldn't introduce an agreed charge with a competitive rate unless the competitive or competition factor is present?

A. Yes.

Q. So therefore, when the Dominion government proceeds with the 30 per cent ---

A. Not 30 per cent, only 30 per cent of the haul up to Diamond Junction, and the reduction is 20 per cent within the Maritimes.

Q. To the extent of the subsidy, to that extent it is an assist to the railways because the shipper should have received that price without it.

A. That is one approach to it; my approach

originally is the level would be higher and we may have got a higher rate.

Q. Well, I just can't help but being concerned about the fact that if the level were higher then it wouldn't be a competitive rate. I think you mean competition.

A. No, we have the right to meet competition as we elect, and we don't meet competition when it is not compensatory, but under the Maritime Freight Rates Act and where you are within the Maritimes themselves and where your level is lower and one complaint has been that competition was strangled. Now, whether or not we have the right of selling high enough to permit truck competition getting it, that is another matter, but on the other hand I must say that perhaps the competitive features would have hit us long ago in the Maritimes without the Maritime freight rate.

Q. I think the Maritime Freight Rates Act is of assistance in its application to, say, class and non-competitive commodity movements, but it is certainly an interesting change in what I feel is the intention of the Maritime Freight Rates Act when you are now receiving the same subsidy provisions on commodity and agreed charges; do you agree?

A. Pardon, sir?

Q. That the result in giving you a subsidy on competitive charges and agreed charges permits you, in effect - puts you in a more favourable position, vis a vis, competition.

A. That is one approach, but I wouldn't

[illegible]

say that is it altogether. We have our problems outside of motor truck competition, and I might say to start with that your Maritime Freight Rate level, as I mentioned a few minutes ago, is generally lower, particularly from central Canada to the Maritimes. And now, I think you were being precise where the suggestion was advanced that the Maritime Freight Rates Act should apply both ways.

Q. And 100 per cent?

A. Yes. I would like to point out that even today you have got a lower class rate level from both Montreal and Toronto into the Maritimes than you have for central Canada. I am not talking about the amount of traffic handled in the class rates of central Canada, but I am talking about the level of rates.

Q. Would you turn to page 4 of your precis, and starting at the first complete sentence at the top of the page there:

> "The other two yardsticks which can be calculated from statistics in the waybill analysis reports are the average amount of revenue per ton and the average amount of revenue per carload. Unless they are properly related to the length of haul, they should not be used for general comparison purposes. The average revenue per car mile which takes into account the length of haul does not indicate directly the weight of the payload carried. Only the revenue per ton-mile

reflects the relationship of revenue
earned to length of haul and weight."

(Page 3110 follows)

I suggest that the basis of revenue per ton mile and revenue per car mile would similarly give you a touchstone, a yardstick, to measure the revenue potential of a particular rate?

A. The ton mile revenue, of course, gives you the complete picture. In other words, the traffic you are handling and the revenue per car mile does not necessarily give you the complete story or the true story. You have various classes of equipment, for example, and there is the illustration I have given you for the dry freight, 120,000 pounds, and tank cars 64,000 pounds. Now, just as a matter of explanation, the tank car of 64,000 pounds is a general standard in Canada; it does not take into account the fact that certain companies are proposing to use jumbo tank cars with a larger capacity. Of course, this is just a general standard.

Q. I suggest that where cost is an issue, as it is in this hearing, the revenue per ton mile distorts the actual situation since it fails to recognize sufficiently the loading and handling characteristics of specific commodities.

A. I am sorry, sir, did you say the revenue per car mile or ton mile?

Q. The revenue per ton mile. You are suggesting that the revenue per ton mile is the best gauge, and I am suggesting that where cost is a factor, where the cost of movement of the commodity is involved, revenue per ton mile, as a matter of fact, distorts the actual situation?

[illegible]

A. No, sir, I am afraid I can't agree with that, for the simple reason that the revenue per ton mile reflects the work we have performed in hauling the freight.

Q. Is it not correct that the revenue per ton mile is the same for an 80,000-pound car as for a 40,000-pound car, the revenue per ton mile would be the same?

A. Yes, sir, there is no question about that; but, as I have tried to stress, only the revenue per ton mile gives us the true picture of what we get for the work performed.

Q. Would the cost be the same?

A. I am sorry, costing is out of my field. I couldn't help you on that.

Q. The very yardstick for use in costing analysis does, in fact, distort it because it fails to recognize the loading and handling characteristics of a specific commodity.

Now, I notice along that line that at the bottom of page 4, the last complete paragraph, Mr. McCoy, you refer to the joint submission of Canadian National and Canadian Pacific, and you state:

> "The purpose of the table is to illustrate that the average revenue per ton mile has risen during this period for all traffic excepting the agreed charge and the statutory and related traffic. The seeming decrease in the revenue per ton mile of the agreed charge traffic can be accounted for by the substantial increase in its average length of haul . . ."

My question is: it would appear that you agree that, while length of haul reduces revenue per ton mile, it does not, in fact prove the traffic less remunerative?

A. No, it does not prove it to be less remunerative. It just indicates that there is a rate of taper. That is actually what it covers, the rate of taper. For example, 94 miles, 3.2 cents; 348 miles, 2.47 cents.

Q. We can take this as a caution on your part to counsel and the Commission that when you are looking at revenue per ton mile we should assess this against length of haul, because while it has the effect of reducing the revenue per ton mile it in no sense means that the traffic is less remunerative?

A. I will agree with that.

Q. On page 5 of your precis, Mr. McCoy, the first complete sentence on that page, it says:

> "The scales taper in favour of longer hauls, thus reflecting the distribution of relatively high terminal costs over longer distances and minimizing transportation charges on long haul movements."

I wonder if you could explain to me what you mean by "relatively high terminal costs"?

A. Well, relatively high terminal costs would cover the major terminals, such as Winnipeg, Montreal, Toronto, perhaps Vancouver. But when you have a long haul shipment you can distribute the cost over various terminals. Take, for example, Montreal

to Winnipeg: we could distribute it over all of the terminals with, say, a switching movement in the Montreal terminal where you are up against tremendous costs. In other words, the load is distributed.

Q. Now, with reference to Exhibit 79-B, which is NT-101, in looking through the list I can only find one which referred to a movement to Eastern Canada, and we from Manitoba just wondered whether there was any foreign competition in Eastern Canada on products in Western Canada.

A. I can assure you, sir, if there are any movements from Manitoba into Eastern Canada which were subject to import competition we would have heard about it and I think appropriate corrective action, or whatever action, would have been taken by the railways. In other words, to the best of my knowledge, no railway company says: "Well, we will only contribute, say, in the British Columbia market in meeting foreign competition." I know that certain Ontario manufacturers have been after the railways saying that they couldn't meet competition in steel even produced in Italy, and we have taken corrective action. In other words, we meet competition where we find it and assuming we can get compensatory rates.

Q. It would be a safe conclusion to draw from that exhibit that, as at the time that exhibit was prepared, and whatever one might read into that exhibit, there does not now exist foreign competition in Eastern Canada for any product produced in Western Canada?

A. Well, I have never been in the production game. But if that is so, I can assure you we would have heard about it and put in competitive rates, provided we could have done so at a compensatory rate. This is only the agreed charge list.

There is a further point, that I think you will find we have put in several competitive rates on agreed charges from Alberta and Eastern Canada, and certain manufacturers of commodities in Alberta are very sensitive about competition in the eastern market.

Q. That wasn't foreign competition?

A. Well, if you could call United States competition, yes, sir. Import competition from the United States is just the same as from overseas.

Q. On going through this list I can only find one agreed charge issued to meet competition from West to East?

A. Well, as you will probably observe, we have highlighted the British Columbia coast points on this exhibit. Now, so far as the west itself is concerned as your competition, say, in Alberta lessens with import competition, naturally you have a different rate scale. In other words, we endeavour not to go beyond that competition itself. If we have a rate proposed, put in front of us, to meet competition at a point like Edmonton or Calgary, we certainly assess all the competition; we don't mark it off altogether. But, on the other hand, the storm centre is at Vancouver and in that area.

Q. It certainly must be my fault that my question is not properly understood ---

A. Well, if you give us the number of the agreed charge you are referring to.

Q. Agreed charge 57, pipe, cast iron, Toronto to British Columbia?

A. Yes.

Q. Iron or steel, from stations in Alberta, Manitoba, Ontario and Quebec,to British Columbia; rods, wire, Hamilton to Vancouver, and you will see that all but one are agreed charges to meet import competition, and this competition is the competition against Eastern Canada, and I just wondered whether from this exhibit it would appear at least there is no import competition in Eastern Canada on products produced in Western Canada?

A. If you have products in Western Canada that are in competition with imports to Eastern Canadian destinations, I can assure you the railways, when they are satisfied the competition actually exists, will establish rates. In other words, Mr. Mauro, as I said before, we meet competition as we find it. We do not pick the origins or the destinations which are set for it.

Q. Exactly. And, therefore, this exhibit shows that in the case of the C.N.R. the only import competition of foreign products is foreign products competition in the western market, and there is no competition of foreign products in the eastern market on products produced in western Canada?

A. We are only talking about agreed charges here. I haven't got my tariff in front of me, but I will say this. Perhaps lack of manufacture is perhaps your problem, and there will be nobody happier than the C.N.R. to see you develop a manufacturing operation out there.

But just go to agreed charge 71. There is a case where the railways have put Manitoba steel manufacturers in the British Columbia market in competition with overseas.

Q. How about putting us into the eastern Canada market in competition with overseas?

A. Well, give us your problem through the regular channels. We will certainly be very glad to look at this.

Q. Well this is the sort of ---

A. I am not trying to debate it, sir, but the point I am trying to make is that as and when there is any material manufactured in Manitoba with the desire to seek the eastern Canada market, we would only be too happy to have them put in there.

Q. I am interested in the western Canadian picture. I notice a tremendous amount of foreign competition in British Columbia, westbound. I was

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

interested in knowing whether British Columbia produced goods which have got into eastern Canada in the place of foreign competition?

A. Yes, sir, we have many competitive trans-continental rates.

Q. Would you point out in that list of agreed charges in import competition the ones from British Columbia to eastern Canada?

I will tell you the only one there is. 264, "wire, rope and cable" from Vancouver, British Columbia to stations in Canada.

COMMISSIONER ANSCOMB: May I ask you something?

Have you got a case in Manitoba where a manufacturer wants to ship east and cannot compete, who has asked for a rate, or been refused a rate?

MR. MAURO: I will wait until you come out to Winnipeg, Mr. Commissioner. We think there is a situation developing where the western industry program is expanding. We think that there are the beginnings of some industries in western Canada; important industries; and it is interesting. At this point, I am only seeking information with regard to that list of agreed charges presently enforced by the C.N.R. to meet import competition, because we have lots of import charges from Manitoba to British Columbia -- but, just to meet import competition.

It is rather an interesting fact that there are no agreed charges from western Canada to eastern

Canada to meet import competition, but a great many to assist the eastern manufacturer to get into western Canada.

COMMISSIONER ANSCOMB: What I didn't understand was has somebody been refused a rate to bring it east?

MR. MAURO: No, I don't have that knowledge. I was just seeking information.

THE WITNESS: Mr. Mauro, ---

MR. MACDOUGALL: Might I make this comment ---

THE WITNESS: Mr. Mauro, you haven't taken into account, apparently, there are competitive rates or, say, normal tariffs. This is only the agreed charge set up.

MR. MAURO: I noted the limitations of that document, Mr. McCoy -- that it is just a list of agreed charges listed to meet import competition.

THE WITNESS: The British Columbia coast is a real storm centre.

Q. There isn't the same degree in eastern Canada for British Columbia products?

A. You have your manufacturer right on the door step of the market. That is the difference, I would say.

MR. MACDOUGALL: Just might I make this comment that Mr. Mauro, in his cross-examination of Mr. McCoy, and the question put to him by Commissioner Anscomb indicates the importance which Manitoba places on the problem Mr. Mauro has been speaking about, which I understand he will tell us about in Manitoba.

I think that points up very clearly the importance of the railways being put in possession of the Manitoba brief on this point as early as possible, because if these questions are to be discussed and met and talked about in Manitoba I think those parties preparing the briefs should let us see them with as much notice as possible before we speak to them in Manitoba.

At the beginning of the proceedings, I think it was agreed that briefs were to be submitted as early as possible before the hearing. We would be glad to have this information as soon as possible so that we can deal with it properly in Manitoba.

THE CHAIRMAN: We are anxious for you to have the information. I know Mr. Mauro is working and has worked; I don't think he has been lazy in this regard, and I am sure he will try to accommodate you.

MR. MAURO: We sent the final bit of it back last night, Mr. Chairman, and as soon as it is printed I am going to get it into the hands of the Commission.

MR. SINCLAIR: I would like to join with my friend in that, on behalf of what we have to do, because if we are not able to have it in advance and with enough time to make the proper analysis, we will have to unfortunately ask some people to stand down, and I am sure we won't want to do that, in view of some of the people who are busy, such as Ministers.

THE CHAIRMAN: I think, Mr. Sinclair, the matter will be resolved, and that you will have the submission in your hands so that you may properly assess it.

MR. MAURO: I think this is certainly a very greater degree of discussion about Manitoba brief than over the Maritime briefs.

MR. SINCLAIR: I must say, sir, that as far as I am concerned we mentioned that when Mr. Mauro was on his feet, but it applies with equal ---

MR. MAURO: Certainly.

MR. SINCLAIR: --- with equal certainy, as my friend says, or whatever word you want to use. My friend, Mr. Frawley, has numerous clients in Alberta, and Mr. Brazier from British Columbia, and Mr, Dickson's right across western Canada, as they are, and ---

MR. FRAWLEY: Mr. Frawley only has one client. That is the government of the Province of Alberta.

MR. SINCLAIR: We want to assist the Commission in any way we can, and not in any way disturb the even tenure of the presentation.

Q. Now, Mr. McCoy, in regard to Exhibit 79-C, "Average Revenue per Ton-mile and Corresponding lengths of haul of Commodity Movements Reported in 9 Waybill Analysis reports by Rate Category",would it be possible for you to supply the revenue for car line figures?

A. We could make a run at it. I think we

could. If you would desire it, I think we could give it to you.

MR. MACDOUGALL: This information on exhibit 79-C is taken from the waybill analysis which is available to my friends just the same way as it is to us. The car miles statistics are there.

THE WITNESS: Excuse me, sir, before you go on. You want another column to the right of the average ton per mile column?

MR. MAURO: Yes.

MR. MACDOUGALL: Mr. McCoy is a reasonable man, and could take it out of the waybill analysis and have it for Mr. Mauro. I do not object too hard over it, but Mr. Mauro could do exactly the same thing himself.

MR. MAURO: I am quite aware that we can take off the same figures, but I wanted it as part of this exhibit, and I would like to put it in as part of Mr. McCoy's exhibit.

THE CHAIRMAN: You want the figures placed side by side?

MR. MAURO: Right.

MR. MACDOUGALL: If he places them side by side, I am sure Mr. McCoy will tell him if he agrees with him.

MR. MAURO: Is Mr. McCoy going to be here?

MR. MACDOUGALL: He will be here anytime the Commission wants him.

THE WITNESS: Mr. Macdougall says I am very reasonable. I try to be, at all times. I hope he

will not be unreasonable. I want the month of March down south. I hope it won't be with the Commission.

Q. On page 6 of the precis, Mr. McCoy, with reference to your table on page 6 headed "All traffic excluding grain and grain products", if you compared the revenue per car from 1951 to 1958, would it have increased?

A. I would have to make that comparison, sir. I haven't taken it out.

There, again, as Mr. Macdougall has said, this information is from the waybill analysis and this can be worked out by either party.

Q. You cannot say now? I don't want you to work this out, Mr. McCoy, but I was wondering whether of your personal knowledge since 1951 the revenue per car has increased?

A. I would not want to make a statement on that without checking it, sir.

Q. In the same vein, has the revenue per ton-mile increased since 1927?

A. Since 1927?

Q. Yes?

A. We would have to check our records sir. My recollection is that it has increased. As a matter of fact, it has increased since 1951, and I would say the same thing would apply to a 1927 comparison.

Q. What about revenue per ton-mile on grain since 1927, per revenue ton-mile?

A. I would say it remained constant. Well, it fluctuated around, as this exhibit indicates, between

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

4.9 cents per ton-mile to 4.93 cents. It would probably be in the same category.

Q. And, also, the revenue per car on grain from 1927 -- do you know if the revenue per car of grain has increased since 1927?

A. I don't know whether that is available or not. We could find out.

THE CHAIRMAN: They are 60 ton capacity cars.

THE WITNESS: They are 60 ton capacity cars, sir.

Q. What were they in 1927?

A. I have a basic material book here. I don't know how far back I can go, sir, but I will do my best. These are the average loadings.

Q. It would be about 40 thousand lbs. capacity in 1927?

A. I cannot go back to 1927. I can go back to 1948 in the information readily available, sir. And, speaking from the combined statistics of the Canadian National and Canadian Pacific on wheat in 1948, the average load per car -- this is all over Canada -- is 51.5 tons. In 1958, it was 55.5.

Q. How about 1927?

A. I haven't got that here, sir.

Q. How far back do you go there?

A. 1948.

Q. Perhaps that information ---

A. This is from Railway Association of Canada statistics. They are public knowledge.

Q. Going back to 1927?

A. I don't know about 1927. I don't know.

Q. I think you would agree that the capacities from 1927 to 1958 have increased appreciably?

A. Yes, the same as the harvesting of grain has improved.

Q. Would the revenue per car increase along with increased capacity?

A. The gross rate would increase, but that would be automatic.

Q. Would not the net rate per car increase?

A. I don't know about that. So far as I know, there has been no study made of our costs in 1927 as compared with 1948 or even 1958 or 1959.

THE CHAIRMAN: All right, gentlemen, we will adjourn.

---Luncheon adjournment.

(page 3128 follows)

---On resuming at 2.00 p.m.

THE CHAIRMAN: All right, gentlemen. Mr. Mauro?

MR. MAURO: Q. Mr. McCoy, I would ask you to turn to page 7 of your precis. You quote there, before the part which is the Judgment on the 15% Case in 1956 -- the part which, I think, we are all particularly interested in is the statement which reads as follows:

> "These factors indicate that it is the freight rate structure itself which is largely responsible for the situation in which the railways now find themselves, rather than any defect in the 'requirements' formula. This difficulty is intensified by the fact that the grain traffic within Western Canada is carried at statutory grain rates which cannot be increased and which yield only one-half cent per ton mile compared with the general average, including statutory grain, of about 1.4 cents per ton mile, or approximately 2 cents excluding statutory grain."

It was my interpretation, and is my interpretation, of that quotation, Mr. McCoy, that the Board is saying that it is the freight rate structure which is largely responsible for the present railway problems, and that these problems are intensified by the statutory grain rate. Do you agree with that?

A. Well, frankly, I don't quite understand your question to me when you say "the freight rate

structure itself." You have lost me, and if you could explain a bit more . . .

Q. I was going to. That is the quotation from the Board.

A. Yes, I appreciate that; but the freight rate structure itself naturally changed as our expenses increased. When you have one large segment of your traffic frozen then the other segment changes. Naturally, there is a difference.

Q. Well, I just . . .

A. They say, as I interpret your question, the requirements formula controls, rather, the rate structure itself.

Q. Well, they are not saying that there are no defects in the requirements formula, but that the freight rate structure itself . . .

A. Yes, it has got out of line because one . . .

Q. But they do say the difficulty is intensified?

A. Yes.

Q. And the difficulty there is the fact that the grain is carried at statutory grain rates; but that hasn't created the difficulty. The difficulty is in the freight rate structure itself.

A. Well, I don't think I would go on that, because, frankly, "the freight rate structure itself" automatically includes statutory grain rates. You can't get away from that; and the difficulty is created because the statutory grain rates do not change upward and downward with the other rates.

[illegible]

Q. Assuming that the Board meant what it appeared to mean, that the freight rate structure is largely responsible for the situation in which the railways now find themselves, and that the difficulties are intensified by the statutory grain rates, and bearing in mind that the Commission have prepared two complete cost studies of the grain trade -- the carriage of grain -- I wondered whether a similar study of the other aspects of the freight rate structure have been so completely investigated by the Canadian National?

A. No, they have not; for the simple reason that the other rates have changed, and in the construction of any rate, when we are getting into a marginal rate, we naturally get our costs. We have done a lot of investigation in the last few years, particularly on competition issues, to get away from our normal rate and into what I would loosely call low-spot rate costing. In other words, that would apply to both agreed charges as well as competition rates.

Frankly, costing is increasing at all times, and, naturally, with a large part of your business at the 1899 level, we felt it was in our interest to make a complete cost study.

Q. Isn't it true that there is a body of opinion building up that perhaps the whole freight rate structure needs reappraisal; that perhaps the value of the service principle as presently enunciated is not the most effective basis of rate-making, considering the new competitive techniques and technology that are in use now?

[illegible]

[illegible]

A. [illegible]

that the [illegible]

tion of [illegible]

ment, [illegible]

of investigation [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

A. The value of the service principle will always be with us, and whether or not it has outlived its usefulness is debatable.

Personally, I feel that the value of the service principle could never be discarded, because as long as the railways find that the ratesbased on the value of service are such as to permit free movement of traffic, with appropriate profits to the railways as well as to their patrons, there is not much wrong with it.

I agree with you that there is certainly a large opinion building up that it should be gone into in detail, but if you are going to do that I would think you would have to take in the entire picture. You would have to investigate industry's costing method ---

Q. I would say that you can't look at the grain cost in a vacuum, and I agree that you can't look at the economic factor of the railroad business in a vacuum, because there are other factors such as labour cost.

A. Yes, absolutely.

Q. I agree with you; but I was told by someone that I discussed this problem with in the United States that the new concept of value of service might be, instead of the value of the commodity itself, the value of the service performed vis-a-vis the mode of carriage. In other words, what is the most efficient mode of transporting goods or people rather than the value of the actual commodity being shipped?

A. That could be one element; I will agree with that. But I might say that I do hope that

Canadian railways will not get into the jackpot that the United States railways are in.

Q. How much goods are being moved under the class rates, Mr. McCoy, in the C.N.R.?

A. I haven't got that with me here.

Q. Would it be more than five per cent?

A. Percentagewise I wouldn't think it would be much more than five per cent; but you must remember that the railways themselves brought the situation out to a certain extent by the establishment of a mixing rule. That would be about five or six years ago. Before that we found a lot of less than carload traffic in pool car operation.

Q. Would you agree with the suggestion that, on the basis that a classification is only moving five per cent of the traffic, perhaps it is time to reassess the whole classifications and restate them in the light of your own practices today?

A. That would seem to be all right, on the face of it. But you have got to look at the human element.

I will go a little further. Let us assume for the moment that we put, say, fifty per cent of our traffic under a class rate. Automatically, local traffic managers -- industrial traffic managers -- who are very allergic to any class rate, would say: "I have got to have something better than the class rate" -- no matter what the level may be.

In other words, the human element enters into the matter, and whether or not a complete

reappraisal or readjustment would bring about any desirable results, I don't know. You would have to experiment in that. But I can assure you that industry -- particularly western industry -- would be very allergic to see any class handling. That has been the history of the past, and I think it would be the same in the future.

Q. You will agree with me in the opinion that when a system, namely, the class rates, are moving five per cent of the traffic perhaps, then, the class rates should be readjusted to reflect the present situation?

A. That is a rather debatable point, as I see it.

Q. At page 9 of your precis, Mr. McCoy, in the last complete paragraph, you say:

"At the time rates on grain and grain products were established on September 1, 1899, on the Crow's Nest level in compliance with the provisions of the Crow's Nest Agreement, these commodities were rated at 8th Class in the Canadian Freight Classification, and remained on this rating until March 1, 1955."

My question is: Following the Crow's Nest Agreement what percentage of grain in Western Canada moved under the 8th Class?

A. May I ask you if you mean in 1899?

Q. After the Crow's Nest Agreement?

A. Well, I am afraid I couldn't answer your question. The Canadian National wasn't even in existence

at the time. I suggest that you ask the Canadian Pacific. I don't know.

Q. It is my advice, and I am advised that this 8th Class was a purely paper rate, that there was no movement of grain under the classification?

A. That may be; I wouldn't dispute that; I couldn't do that. I don't know.

To give you a general answer, I do know that there were commodity rates under the 8th Class in certain series.

Q. I refer you to page 11 of your precis and to Statement NT-105 which indicates from Winnipeg, on the short rail line, a distance of 419 miles and that the statutory rate to Fort William is 14 cents per hundred pounds. The percentage ratio of that rate to the September 12, 1927, 8th Class rate is 31.1 per cent. Whereas the rate from Winnipeg to Fort William is 14 cents per 100 pounds. If that were to be increased by 100 per cent the rate would be 28 cents?

A. Well, if the Commission here rules that we should be compensated on the basis of 100. I didn't put a firm percentage on it, because I have mentioned 123 per cent as bringing us out of the hole. We haven't put in any specific amount. We have left that up to the Commission.

But looking at page 13 -- the bottom of page 13 and the top of page 14 -- the last sentence reads:

"Consequently, we have submitted the information on rates past and present applicable in Canada and in the United States along with an

[illegible]

indication of the level that established rate-making principles would suggest, in order to assist the Commission to determine what would be a just and reasonable level of compensation."

Q. Have you proposed any rate from Winnipeg to Fort William?

A. I don't recall that we have in this submission -- not a specific rate; but, as you say, 100 per cent would make it a 28-cent rate, and that would bring us back to exactly the rate that was in effect in 1884.

Q. At the foot of this page -- the last complete paragraph on page 11, Mr. McCoy -- you say:

"This method of rate adjustment, if followed to a conclusion, would seriously distort the existing rate pattern, and it is our view that, as the geographical centre of the grain-producing area now lies in Saskatchewan, an acceptable key rate could be the Regina to Fort William commodity rate, presently 28 cents per 100 pounds."

Since under the proposal, as I understand it, of the Canadian National it is intended that there would be an increase in the cost to the shipper why are you concerned about distortion?

A. Well, we feel that from the realistic rate approach, the railways, on this particular traffic, should not unduly distort the rate pattern. Mark you, we have no illusion but that industry will do that. We feel, in fairness, by keying on Regina -- which is,

perhaps, the centre of the wheat-growing area -- we have taken a realistic approach, and certainly the railways are not going out with any idea of deliberately upsetting the applecart, so to speak.

(Page 3140 follows)

Q. But your proposal here, surely, is based on costs and not just sort of relating it to a rate basis; your complete statement is the cost analysis.

A. Well, it is really our cost analysis, certainly, I have no objection to saying that, but if you feel we are wrong and you have another suggestion, as long as we come out whole in the matter, I think we will be very glad to have it.

Q. I was suggesting that, perhaps, the costs, for example, from Winnipeg to Fort William should be a governing factor rather than the flat percentage increase across the board, and especially since the shippers are not involved in this, so it will not disturb any rate relationship at all.

A. That may be, but as far as costs are concerned if you are going to relate your costs only from Winnipeg to Fort William and you haul the bulk of your business from the Regina area to Fort William, there is going to be something out of line.

Q. The rate from Regina to Fort William will naturally be greater than the rate from Winnipeg?

A. Yes. I misunderstood you.

Q. That is the main point; the cost factor should be reflected upon each major point.

At page 12 of your precis you refer to statement NT-106, which is Exhibit 79-G, and that is a statement entitled, "Rates on Wheat for Hauls in western Canada Compared with Rates for similar hauls

in Western United States". And now, you specify the rates on wheat to Duluth, and I was wondering and it might be of a little assistance to the Commission and to myself if you have any idea of the rates on other grain to Duluth?

A. We could get the information; we could review the tariffs, but it is my understanding they are the same.

Q. And then, the other question in conjunction with that which would be of assistance to us would be the minimum weights in the United States.

A. Well, we get that from the tariffs, the same as we have in Canada.

Q. I think it would be very helpful to the Commission to see that.

A. We can undertake that study, sir.

Q. Would you also provide us with the figure for movement of grain on domestic rates for the equivalent distances in Canada, and the American rate on each?

A. What you have in mind, if I understand you, is you want the rates on domestic grain from York, North Dakota to Duluth.

Q. That is right.

A. I don't recall at the moment whether or not there are any specific furtherance rates to Duluth. I know that there are special rates or proportion rates, as we call them in our phraseology, from Chicago, but whether or not there is a

[illegible]

differentiation of the rates from Duluth for domestic, I don't know that, I would have to check it.

Q. I would also like to know the equivalent mileage rate in Canada. If you are using York, North Dakota, as 420 miles, could you get an equivalent of 420 miles for the domestic rate in Canada?

A. We could use our western Canadian mileage.

MR. MACDOUGALL: Would you be satisfied with two or three of those, or representative ones?

MR. MAURO: Just a couple there.

THE WITNESS: Would you like to pinpoint something on that? It would help us a lot if you did that; the origin.

MR. MAURO Q: My advisor says it doesn't matter; it is on a mileage scale for anyone you want to choose,that would be satisfactory.

A. All right.

Q. Do you know, Mr. McCoy, what percentage of the grain moving to Duluth is for export?

A. No sir, we wouldn't have that information.

Q. That is rather an important distinction, is it not, Mr. McCoy?

A. Well, if you mean from a transportation standpoint it might be an important distinction, but I think you will find that the greater use and consumption of grain grown in the United States is in the eastern States. In fact, what the percentage

is for domestic use and as far as export is concerned, I don't know whether or not we could get that, I doubt it, but your concentration of population is not at Duluth, I will admit that.

Q. But I mean moving for domestic consumption as opposed to export. The reason I am very interested in getting that figure is because even here in Canada the Canadian railways move grain from Port McNicoll to Montreal and from Fort William to Saint John's at rates as low as or lower than Crow can return, and they tell us that this is necessary in the export trade and to generate traffic.

A. As Mr. Edsforth has said, the Canadian Pacific railway and the Canadian National railway are in the same jackpot in that when we look at these reports we find that for many years Canadian lines have, as you know, adopted the policy of using Canadian ports to a great extent; perhaps not to their dollar enhancement; we may have lost money, I don't know, but we certainly can take a pat on the back for our zeal in trying to protect Canadian ports.

Q. And also to protect the Canadian export industries and I think that is why it is important for this Commission, if the information is obtainable, to ascertain in regard to that exhibit the percentage of grain moving in the United States for domestic consumption and the percentage moving for export consumption, in order to assess the position of movements here in Canada.

A. Of course, Mr. Mauro, assuming that we do get the information to Duluth, which I doubt, there is the other factor to look at; you have western grain moving through Canadian cities and Canadian ports, and in that respect you only have a very small portion of the entire picture. I would thank you very much if I could get that information; we can get rates, but the exact tonnages from places like New Orleans would be an impossible task.

Q. I was wondering if there were statistics as to the actual consumption in the domestic market of American grain and the amount of movement to exporters.

MR. MACDOUGALL: You remember, I think, Mr. Sinclair spoke about it yesterday when asked by someone to get the breakdown between the grain coming to Fort William that went to final export and that which went to domestic channels, and that he was unable to do that, and I would doubt very much from what I know whether Mr. McCoy would have any luck in trying to find the breakdown between domestic and export grain going to Duluth; I don't know how he could get that.

THE WITNESS: The only source I could think of would be the United States Department of Agriculture.

THE CHAIRMAN: I think it is a question of lower rates from east of Fort William indicating, in any event, how the railways are being used as an international power.

MR. MAURO: That is the point, and perhaps I wasn't very subtle. You can't compare the American rates with the Canadian rate unless you know whether it is a movement for domestic or export use, and we have different rates in Canada; that was the only purpose of the question.

Q. Now, on page 13, Mr. Mauro, the second line of the complete paragraph you say, "also this traffic produced only 6 per cent of the total Canadian National (Canadian Lines) revenue, but required 19 per cent of the total freight transportation service." Could you tell me what you mean by "freight transportation service"?

A. The amount of their hold; in other words, it consists of 19 per cent of the total work which we performed in freight service in Canada. I don't think I could go further than that, I think it is self-explanatory.

Q. Is that net ton miles or car miles or tonnage train miles?

A. It is - Mr. Bandeen's exhibit here, Exhibit 57-JJ it is the revenue ton miles.

Q. Revenue ton miles?

A. Mr. Bandeen is the man that you should request that information from, sir; I think it is in Exhibit 57-JJ, that is where you get the information from.

Q. So that we can interpret "freight transportation service" as revenue ton miles, that it represents 19 per cent of the revenue ton miles?

A. Yes sir, revenue ton miles.

Q. Do you know what the percentage of grain train miles of total train miles might be?

A. No sir, I haven't got that.

MR. MAURO: Well, I understand also that if I can recall correctly Mr. Bandeen said he had worked out some kind of a figure, and then he worked out an equated figure, and maybe, Mr. Macdougall, if it is available you might let us have that; the percentage of grain train miles and total train miles.

MR. MACDOUGALL: Well, I remember you asked Mr. Bandeen for that information and you got an answer from him on the point. I think he told you that the information was in the working papers and in the precis he filed and you could get that information yourself.

MR. MAURO: We could get it ourselves?

MR. MACDOUGALL: As I recall it.

MR. MAURO Q: I am advised, Mr. McCoy, in the same general approach to earning traffic patterns and traffic imports that it is also correct that passenger train miles in 1958 represented 36.5 per cent of the total train miles in the Canadian National system and only 7 per cent of the revenue.

A. I am sorry, sir, but you are away out of my field when you are talking about passenger revenues; I am not qualified to discuss it.

Q. So, you wouldn't be able to - you said at page 13 in the last paragraph, "These statistics are mentioned to stress the importance of the economic

[illegible]

problem faced by Canadian National in handling this grain traffic." What about the economic problems in handling passenger traffic?

A. I am sorry, I am not qualified to discuss passenger matters in any way, shape or form.

Q. You would have no idea what passenger fares would have to be increased in order to ---

A. I couldn't approach that.

MR. MACDOUGALL: I think we have informed the Commission - I don't know whether formally or not - that it is our intention to make a statement in respect of passenger train service in response to the Commission's indication of its interest in this subject, and we will do that at a later date, at which time this question can be asked.

THE CHAIRMAN: Thank you.

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Q. I have one final question, Mr. McCoy, with reference to Exhibit 79-B, which is an exhibit entitled -- that is right, it is 79-B -- and my question is whether any of the commodities listed in that exhibit are shipped from Manitoba to Vancouver. This is in line with what Commissioner Anscomb asked me this morning as to whether or not we were sort of carrying on a fishing expedition or whether we had any particular product in mind vis-a-vis the eastern market.

My question now is: have you established a number of agreed charges to permit eastern manufacturers to compete in the British Columbia market against foreign competition?

A. Agreed Charge 71 includes Manitoba, and outside of that I don't see anything here from Manitoba. But I do say that if there is any movement or any traffic offered from Manitoba and we can get it by rail we will certainly be glad to make an appropriate rate.

Q. What about item 82, oil, edible and hydrogenated?

A. I do not know of any place in Manitoba where it is produced.

Q. Where edible oil is produced?

A. In Manitoba? You may have some, but I don't know of any. Certainly all three points in the Agreed Charge are Canadian National, also Canadian Pacific, and I do not qualify myself to speak for Canadian Pacific.

Q. What about pipe, pressure, cement

containing asbestos fibre and couplings?

A. I would have to check the western rates to determine what they pay today. They may have a competitive rate or low commodity rate. But certainly I can assure you that there is no question of trying any discrimination or trying to block any western Canadian manufacturers out of any Canadian markets.

Q. I wish to put this question on the record. It would be helpful if we could get some appreciation of the type of traffic represented by each one of the classes. Would you please file with the Commission one commodity which you, as a traffic expert, consider typical of each of the following classes: 100, 85, 70, 55, 45, 40, 33, 30 and 27?

Would you give also to the Commission what you consider to be the effective rate on each one of those nine ---

A. You mean the rate under which the traffic actually moves?

Q. Yes; just using your best judgment, the effective rate on each of the commodities you have just named ---

A. We would have to go by the freight analysis.

Q. --- between Montreal and Toronto, and if we could have the rate in 1920 and the rate in 1958.

MR. MACDOUGALL: I may not have understood this. Is Mr. Mauro asking for Mr. McCoy to tell him what a representative commodity would be that moves under Class 185, and so on?

MR. MAURO: Yes, from Montreal to Toronto.

MR. MACDOUGALL: Surely that is the purpose of the freight classification which is on file with the Board. Anybody who has a copy of that could look up the commodities listed in each of the groups, and that is as available to Mr. Mauro as it is available to any man on the street. I hardly see the necessity of putting Mr. McCoy to this -- there is no difficulty, but I do not see the point, Mr. Chairman.

THE CHAIRMAN: Before we direct Mr. McCoy to answer that question by furnishing the material, we will check with out own advisers.

MR. MAURO: You see, sir, we would like to tie it up with Exhibit 79-H where they have given from September 17th, 1920, the statement showing what rates in effect September 13th, 1920, on wheat from representative origins in Western Canada to Fort William would be if subjected to all subsequent general freight rate increases or reductions authorized by the Board of Transport Commissioners; and we would like to see a similar type of statement showing what the effective rate is on representative commodities under the classes suggested, along with what the rates would have been had that commodity taken all of the increases to December 1st, 1958.

MR. SINCLAIR: 1899 to 19 ---

MR. MAURO: No, 1920, just the same as the C.N.R. have done here.

THE WITNESS: Of course, the railway may not handle the business, particularly for a large section of the year. We are not comparing like with like when

you are comparing Montreal and Toronto. I have no objection to comparisons, but I should like to compare like with like.

THE CHAIRMAN: Mr. Mauro, that has been objected to, and we don't want to clutter up the record with unnecessary things, and if we feel accordingly it will be done.

COMMISSIONER MANN: One question that has something to do with the discussion you had earlier with Mr. Mauro about vegetable oil going eastward from the prairies. Is there an agreed charge on the rape seed oil?

THE WITNESS: My recollection is that there is. I would have to check that.

COMMISSIONER MANN: What was the reason for making that agreed charge?

THE WITNESS: I would have to check. I would test my memory if I gave you an answer.

MR. MAURO: I am advised that there is not an agreed charge on rape seed oil; it is a commodity rate.

COMMISSIONER MANN: I would like to have that checked.

THE CHAIRMAN: Mr. Doherty?

MR. DOHERTY: I have no questions.

THE CHAIRMAN: Mr. Dickson?

MR. DICKSON: Thank you, Mr. Chairman.

CROSS-EXAMINATION BY MR. DICKSON:

Q. Mr. McCoy, first of all, one or two

[illegible]

questions on these movements which are excluded from the Waybill Analysis, those appearing at the bottom of the page of your memorandum, Exhibit 79, and in particular the traffic originating or terminating at rail points outside of Canada. Can you tell me what the volume is, expressed in either tons or ton-miles, approximately, which moves under that particular heading?

A. No, sir; I have not got that particular information available.

Q. Could that be obtained?

A. It would be a tremendous job, sir. I certainly wouldn't want to undertake it, because, after all, when you look at the interchange points at the border with the United States carriers -- and what it would show I frankly don't know, because, dollarwise, Canadian railways only get a portion of the revenue, and you would have varying divisions by each gateway. It would be almost impossible to get something realistic within a reasonable time.

Q. Is it a substantial movement?

A. Yes, it is; there is no question about that. As a matter of fact, Exhibit 58-14 in the Revenue Case shows that our international overhead import, export and other related traffic contributed $159 million.

Q. Out of a total of?

A. 557.7 -- 27½ per cent. There is a large movement of newspaper from Canadian mills; as a matter of fact, there are two or three trains a day out of Rosebud.

[illegible]

Q. Does that move on a ton-mile basis above or below the revenue per ton-mile which you show on page 6 for all traffic excluding grain and grain products?

A. You mean as a through movement or just the Canadian mines proportion of the through movement?

Q. Let's say as a through movement?

A. I have never made that comparison, because we have to be governed more or less by the level of rates in the United States. In other words, the Canadian railways, when they are transporting international traffic, are largely governed by the rate levels in the United States, and to put a ton-mile figure on it -- the only thing you could do would be to get your Interstate Commerce Commission figures.

Q. But within your system you do not have any revenue per ton mile for this traffic?

A. No, sir, not to my knowledge. As a matter of fact, it would be a tremendous task, because your divisions or your proportions are not the same, all gateways. We have probably four or five interchange lines, say around the Niagara frontier, and divisions, of course, are not lovely property, but I can assure you they are only as a result of hard bargaining.

Q. You don't know whether that is a figure which would depress or inflate these revenue figures?

A. No.

Q. Can you express any opinion on the rail-lake-rail movement?

A. In the rail-lake-rail movement you will find the rates are differentially lower than the all-rail rate. For instance, water routes do not necessarily follow the rail routes. Our water route is through Fort Edward and north to Fort William. The rail route goes through North Bay, Capreol. You wouldn't have the same distance. You are not comparing like with like, although you do have a lower revenue picture.

Q. And the ocean-rail?

A. I would understand that to be import through; in other words, from the U.K., continental and so on, and it would be hard to make a comparison on that, because ocean distances wouldn't help you very much.

Q. On page 4 you state:

> "The other two yardsticks which can be calculated from statistics in the Waybill Analysis reports are the average amount of revenue per ton-mile and the average amount of revenue per carload."

And then you continue:

> "Unless they are properly related to the length of haul, they should not be used for general comparison purposes."

Now, would you turn to page 6? To what extent do you relate length of haul for the movement of grain and grain products to the length of haul for all traffic excluding grain and grain products in trying to make some comparison between those two columns in revenue per ton-mile?

A. Well, frankly, I do not altogether understand the question. But if you will go to the table on page 6, we highlight the average haul of grain and grain products and also all traffic including grain and grain products. In 1958, 341 miles average, all traffic excluding grain and grain products, and the revenue per ton mile is 2.09 cents. On the grain traffic for more than double the haul, 852 miles average, the revenue is .50 cents. In other words, we have taken the average haul of all traffic and of grain and shown a realistic comparison of the two. But, as I say, I am not clear as to what is behind your question, sir, I am sorry.

Q. What is the significance of the difference in average length of haul and the revenue per ton mile figures?

A. Well, the significance is that for a haul of 852 miles in 1958 we only received half a cent a ton-mile, whereas for a haul of 341 miles we received 2.09 cents. In other words, on the grain we only received one-quarter of what we received on the other traffic.

THE CHAIRMAN: That is on traffic other than grain on a shorter haul?

THE WITNESS: Yes, for a shorter haul.

MR. DICKSON: Q. But on a longer haul, to make them proper and comparable, you should take like for like on the length of haul. Your precis suggests that unless they are properly related to length of haul they should not be used for general

comparison purposes?

A. I think they should be used for general comparison purposes, but the average haul not being the same, you have to take up the realistic view. You take your average class rate, 652 miles in 1958, the average revenue is 4.05 cents; on statutory rates, 852 miles, is half a cent a ton mile revenue. Now, a difference between 652 and 852 is 200 miles, but there is no other segment of the traffic other than the class rates which matches up to the work we perform on the statutory rates. I think we have tried to give a representative cross-section in Exhibit 79-C on our normal commodity rate charges, agreed charges, competitive rates and statutory and related class.

(Page 3160 follows)

Q. Again, you aren't giving effect to the difference that went for haul, are you?

A. Well, as near as we possibly can, I have given it to you in the class rate of traffic and the statutory.

Q. Two hundred miles difference?

A. Two hundred miles difference, yes, that is correct.

Q. At the top of page 5 you indicate the scales taper in favour of longer hauls, thus reflecting the distribution of relatively high terminal costs over longer distances and minimizing transportation charges on long haul movements.

Now, am I correct in assuming that if this traffic on page 6 which you entitle "All Traffic Excluding Grain and Grain Products" were moving an average haul equal, say, to the grain traffic, that one might expect these revenue figures to be substantially reduced?

A. I would not say substantially reduced. They would taper down, but certainly not substantially reduced. Definitely, not to a half a cent a ton mile.

Q. There would be some reduction?

A. There might be some reduction, yes, sir.

Q. Now, further on page 4, near the bottom of that page in the last full paragraph, were you speaking of the joint submission in paragraph 34 -- about half way through, you say "the seeming decrease

in revenue per ton mile." What is the significance of the word "seeming decrease"?

A. The extract is:

"The seeming decrease in the revenue per ton mile of the agreed charge traffic can be accounted for by the substantial increase in its average length of haul, the greater variety of commodities covered by agreed charges and also by the necessity of meeting market competition form foreign sources, particularly on the west coast".

Now, we are dealing with agreed charges only in that paragraph. The average haul in 1949, as shown in Exhibit 79-C is 94 miles, the revenue ton mile 3.02 cents.

In 1958, the average haul had increased to 348 miles and the revenue ton mile, 2.47 cents, or a decrease brought about by the increase in the average haul. In other words the rates have tapered.

Q. But there was an actual decrease in ton mile revenue but, by reason of the decrease and length of haul, the business is still, in your opinion, profitable?

A. Yes, sir.

Q. That is the position?

A. That is the position, yes, sir.

In fact, if there are any unprofitable agreed charges, I would like to know about them.

Q. In the case of agreed charges, the increase in the length of haul in spite of the decrease

in revenue per ton mile has had, in your opinion, the effect of keeping this as profitable business?

A. Yes, sir. I would say that the agreed charges are definitely profitable business. If they aren't, I am in an awful spot.

Q. The effect of the increase in the length of haul on agreed charges has a similar effect in considering grain and grain products?

A. It can be related, but I would like to point out that the average haul under your statutory rates at 852 miles, as against only 341 miles on agreed charges. That's taking the year 1958.

Q. Right. Do you recognize, Mr. McCoy, the increase in the average haul per ton mile of grain and grain products of approximately 100 miles as the taper-off shown in the period 1951 to 1958?

A. I can understand -- you would have the 758 figure as compared to the 852 figure. That would be largely due, no doubt, perhaps, to a change in your crops per year.

Q. I suppose it might be affected by the increased amount of grain going through Vancouver, too?

A. Well, I haven't got that in front of me. I know the handling through Churchill have increased during the past few years.

Q. The fact remains there has been an increase?

A. Yes. Everything is changing, sir, but the statutory grain rates.

[illegible]

Q. You made a reference this morning which wasn't clear to me, Mr. McCoy, of publicity defeating you in an attempt to get an agreed charge on some attractive accounts. Would you mind telling us why that was?

A. Certainly, sir. We made an agreed charge, on a certain date, from Montreal to Toronto. We signed to one firm and a competing firm wanted the rate but they didn't like the fact that they would not be on the title page of the agreed charge. They only gave us notice of intent.

I gave that statement to you to indicate the highly competitive situation between industries. That's all I had in mind there, sir.

Q. That is all that was involved in that?

A. Plus a rather rough telephone call.

Q. You indicated this morning that you were seeking to increase the number of agreed charges; is that correct?

A. Yes, sir. I think I can perhaps say that the agreed charges are not static. They are being constantly reviewed to see -- to make sure they are on a realistic competitive basis. In other words, competitional change. And we try to change that competition, or perhaps I should say roll with the punches.

Q. And you are seeking to increase the number of agreed charges through that particular medium?

A. We are seeking to increase the number of

agreed charges in any way we can, because our competitors -- and I'm not complaining about them -- but our competitors definitely go out and try to get business from us. We have the contractual privilege and we try to protect ourselves in that way.

Q. By getting a committed volume of business ---

A. Yes, sir.

Q. --- at a lower rate than what might otherwise be charged?

A. No, not at a lower rate. I know that is the general impression, but under agreed charges we try to make them realistic competitive rates. In other words, an agreed charge is not a give-away rate. I would like to stress that, because while we have been approached -- I am the first to admit we have been approached on many occasions in giving up our rate -- that we should have a lower rate. We take a rather dim view of that approach.

Q. Why would a shipper ever agree to permit his movement to your particular line if he was not intending or hoping to get some benefit rate-wise?

A. Perhaps he likes our service. He has a year round service, and there may be a variety of reasons. He may want to work with us. He may prefer us to some other method of transportation.

I hesitate to mention this, but many shippers want to remain competitive with their competitors. And, by the same token, they want to keep in with us

because we buy certain commodities, and that is one reason why some people stay with us. It is in their financial interest to do it.

To indicate agreed charges are sub-normal because a fellow signs a contract -- that is entirely wrong. Because the other fellow doesn't have to sign. You don't put a gun to his head and say "you have to sign".

Q. But this applies in the normal course -- as an invitation for him to sign, he would expect to get something lower in the way of rates?

A. It doesn't work out that way. I had the same thing put to me by an American in Tulsa, Oklahoma. He has the same problem as you are confronting me with now. We definitely do not go any lower than we have to, be it market or transport.

Q. But you do come down to the truck competition, if that is the competition; is that correct?

A. We meet it to the best of our knowledge and ability.

Q. By meeting it with a lower rate than he would otherwise be charged?

A. You are in a fallacy there. You say a lower rate. The trucks have a lot of services that the railways do not have . In other words, a trucker may load and unload the truckloads. The car load freight is unloaded by the receiver -- unloaded by the shipper. There are a lot of other services in truck movement which are not the case in respect

[illegible]

to the railways.

And I will go a little further and tell you that we tried for years meeting truck competition by publishing the truck rates. We had no success whatever in getting it back. Sometimes we didn't get the printing rates out of the tariff.

Q. You did go below them and get the business?

A. In some cases, yes. And in other cases, no.

In some cases, the trucks have attacked us in other quarters. We may have got the business, say, fromA to B,and they would attack us from B to C. In other words, you cannot altogether meet the trucks competition. You cannot meet truck competition by publishing truck rates. It is impossible.

Q. Each one is an individual problem?

A. There is a lot of fast foot work.

THE CHAIRMAN: Do you not publish any competitive rates that are not compensatory?

THE WITNESS: Oh, no, sir. No. As I said this morning, when we get into our low spot rates, we definitely put our costs on.

THE CHAIRMAN: In some cases, you can't meet the competition?

THE WITNESS: In many cases, we have to say we cannot meet the competition. We do not put motor trucks competitive rates in that are not compensatory. If we do, we have made a mistake.

MR DICKSON: Q. Mr. McCoy, returning to another subject

in Exhibit 79-D, you indicate the bushels of grain handled in various years. If in any of those years there had been an increase in grain movement by, say, ten per cent, what effect would that have had on the profits on your system?

A. The handling of the grain itself, of course, would leave us in the same position we are in now -- perhaps a worse position. I am not talking about the grain itself but the additional money in the farmer's pockets, we will say, in western Canada might well have the effect of priming the pump a little bit. He might be able to buy more refrigerators and automobiles, or perhaps a trip to Florida.

We would benefit to a certain extent on westbound freight, but certainly not on the grain. Our profit on the westbound freight is not as good as it used to be because on motor truck competition we have had to put in a host of competitive rates from eastern to western Canada. In other words, we have not altogether benefited to the extent perhaps we should have, because we find in many cases there is a rather weird set of rates in effect. There will be a level westbound where the trucks have pretty good pickings; and eastbound, they will probably take anything they can get just to get a few dollars. If we could find out exactly what is going on, we would be happier.

I have even heard of flour shipments from Winnipeg to Toronto. I don't think it is a regular thing, but ---

Q. Are you suggesting apart from this secondary benefit through the increase in the equity to farmers, if your movement was confined to increased grain that that increased grain movement would result in an increased loss position for the C.N.R.?

A. Yes, sir, I would say so. As a matter of fact, assume for the moment we are satisfied we are losing money on what you might say a short crop year. The more you handle, the more you are going to lose. That is the way I see it.

Q. You seriously believe that is the position?

A. Yes, sir, I do.

THE CHAIRMAN: We will take a five minute recess.

---Recess.

(page 3172 follows)

Q. Mr. McCoy, on page 6 again -- your table -- and particularly to the portion bearing the title "Grain and Grain Products -- Revenue per Ton-Mile," I understand that that does not include the revenue per ton mile which you obtained from the movement of other than export grain; is that right?

A. That is tied up to statutory grain traffic. In other words, it would be domestic traffic that might be carried to Eastern Canada by rail, to Fort William, but the movement to Churchill and the Pacific coast ports would be export only.

Q. At what rate does this domestic grain move?

A. We could give you that information. The rates are available in the tariff But it is materially higher -- I can assure you of that. In fact, the grain rate local rates have been before the Transport Board in the last few years.

If you have half a dozen representative origins and some destinations you would like we can have the figures taken off.

Q. With specimen origins and destinations I am quite happy.

A. There is another point I would like to make, and that is that I would doubt if there would be any great amount moving to Churchill, Manitoba. We could give you the range. They would be mostly paper rates; but perhaps Vancouver would be a good representative destination. Unfortunately, we have got to hedge that around with the fact that on feed grains

there is a subsidy. It isn't the rate that would be shown in the Tariff itself.

Q. Perhaps I should ask what percentage of movement is domestic grain of the overall grain and grain products moved?

A. I haven't got that figure.

Q. Could you give us an estimate?

A. We could try and work one up. I wouldn't guarantee that we could work one up.

Q. Will you endeavour to do that?

A. We will endeavour to do that, yes.

Q. Does that figure of revenue per ton mile...

MR. MACDOUGALL: I am sorry, that last question -- did you ask about export and domestic grain?

MR. DICKSON: Yes; export and domestic grain -- the percentage of the whole grain movement represented by domestic grain.

MR. MACDOUGALL: We can't give you that.

MR. DICKSON: We had better have it over the system.

THE WITNESS: You mean exported out of the country?

MR. DICKSON: Q. The grain which you have in your table here. You have certain figures here for grain and grain products moving to export positions, and I would like to know if . . .

MR. MACDOUGALL: He didn't call that export grain.

THE CHAIRMAN: Is it not a fact that the higher rate for domestic grain in the prairies means

that a lot of that grain is moved by truck?

THE WITNESS: I wouldn't say all of it, no; I don't think so. There may be some moved by truck. I know there is a movement of flour from Medicine Hat, Portage la Prairie and Winnipeg, and I believe by using competitive rates we got the business back. But it is my understanding that, where there is truck movement, there is no doubt about . . .

THE CHAIRMAN: What about feed grain?

THE WITNESS: Feed grain -- there may be some of that, yes.

But my understanding of the question is that you want the general percentage of grain consumed in Canada as compared with the grain exported out of Canada?

MR. DICKSON: Q. Yes.

A. I might be able to get that from D.B.S.

MR. MACDOUGALL: Excuse me; I don't like to disagree with Mr. McCoy, but that we tried to get from Mr. Brazier and we couldn't get it.

In the first place, we don't know whether you want it by dollars or tons, or how you want it. And I assume, in fact, when we talk about export grain, the grain that goes to the lakehead is sometimes called export grain and included in the statutory-rated grain.

THE CHAIRMAN: That is to Ontario and Quebec?

MR. MACDOUGALL: Yes; everything that comes into the lakehead can be at the statutory rate. It may be exported; and we are then in the great difficulty, in getting the information Mr. Dickson wants . . .

THE CHAIRMAN: Can I suggest that you see Mr.

McCoy, and I am sure if Mr. McCoy can get the information for him he will make it available.

MR. DICKSON: Q. I shall put the question this way, as to the percentage of grain and grain products moved at domestic rates. Would that simplify it?

A. No; that would make it almost an impossibility, because you have export rates in the east as well as domestic rates and so it would not give you the entire picture, because there is an awful lot of grain moved by vessel from the lakehead even down to the Maritime Provinces.

MR. MACDOUGALL: Perhaps we could just speak to Mr. Dickson after to see if there is any way in which we can help him, and if there is we would be glad to do so.

MR. DICKSON: We can consult on that.

Q. In the matter of feed grain, Mr. McCoy, are the feed grain revenues from those movements included in the revenue per ton mile of grain and grain products?

A. Yes; the export position so far as Vancouver or the British Columbia ports on the coast are concerned and also the domestic export.

Q. It is just the export movement?

A. Yes; to the Pacific coast ports and to Fort William and Port Arthur.

Q. Coming to page 7, you have a sentence which precedes the quote from the 15% Case -- two sentences ahead it reads:

"However, as the statutory and related rates are kept at a constant level and as increased competition necessitates the establishment of many additional competitive rates, the railways find it difficult to improve their overall average revenue per ton-mile without attempting to place on the non-competitive traffic the burden of increased operating costs . . ."

What do you understand is the non-competitive traffic?

A. The traffic which is not subject to other modes of transport, or not subject to import or market competition. In other words, another cruel phrase is, perhaps, "competitive traffic to railways." For example, I would say iron ore might be one.

Q. Would most of the traffic of the Prairie Provinces fall into that category?

A. No, not by a jugful -- no, sir. As a matter of fact, if you look at our Tariff you will find mentioned the motor truck competitive rate, and in the east-west territory the same. Competition has spread out, as I said this morning, from one end of the country to the other. I mean, highway competition.

Q. You have quoted, on page 7, this extract from the 15% Case . . .

MR. DICKSON: I suggest that, as it stands, it is somewhat bobtailed, as evidenced by some of the questions and answers which you have given earlier.

I would like, with the Commission's permission, to quote from several paragraphs which precede this

[illegible]

particular section, so that it is in the record.

This extract, Mr. Chairman, commences with the words "These factors indicate . . .", and I suggest, without knowledge of the other factors to which reference is made, it isn't, perhaps, satisfactory.

THE CHAIRMAN: Go ahead.

MR. DICKSON: I quote from page 91 of Canadian Railway and Transport Cases, Volume 76:

> "It will be noted from the above table that the proportion of the revenue from 'class rates' has declined materially since 1949, and is now only approximately one-half of the 1949 proportion. Class rates are the highest rates charged by the railways and it is apparent that a large part of the class-rated traffic has either been diverted to highway transportation or, if still hauled by the railways, is now carried at lower commodity rates, competitive rates, or agreed charges.
>
> "It may also be observed that many commodity rates are now made by the railways by simply reducing the rating in which an article is classified from one class to another class. Some of these reductions in classification ratings have been carried forward over a number of years.
>
> "It will be further noted in this respect that the revenue at non-competitive commodity rates has declined from 53.7 per cent in 1949 to 41.3 per cent in 1956.

"The fact that the competitive portion of the traffic has increased from 8.9 per cent to 21 per cent, and the agreed charges (largely based on competition) have increased from 2.4 per cent to 10 per cent, is substantial confirmation of the situation with regard to the class and non-competitive rates."

Q. On page 9, Mr. McCoy, about the middle of the page, you refer to the fact that in a particular year only 44.4 per cent of the production was handled by rail. Do you see that?

A. That is Exhibit 79-D, page 4.

Q. It appears in 79-B.

A. Line 12 -- at the extreme right of line 12?

Q. Yes. The fact is, I suggest, that in the years you indicate there -- 1957-58 down to the year 1953-54 the actual total of bushels moved has been very much of a constant; is that a fair statement?

A. Well . . .

Q. There haven't been many wide fluctuations?

A. Yes, there have been wide fluctuations. I have not got the car loadings here, but I think they would indicate very clearly there have been large fluctuations.

Q. In bushels moved?

A. I would say large in bushels moved, flowing from the car loadings.

(Page 3185 follows)

Q. Do you feel that this exhibit supports that view?

A. Well, 70.6 per cent is the ---

Q. I am not talking about percentages, Mr. McCoy, but bushels, actual bushels moved in each of these years?

A. In other words, you are talking about the second column from the right?

Q. That is right, and I suggest to you that a perusal of these figures would indicate that actually there is surprisingly little fluctuation in the actual bushels moved in that five year period.

A. Well, in the 545 group or the 514, 586,and the other extremity is 582, 754; in 1957 - 1958 that is the difference of 68 odd million bushels, and I would say that is a substantial difference.

Q. A little over 10 per cent.

A. Ten per cent is high in some things.

Q. You regard that as a wide fluctuation?

A. Certainly. A ten per cent increase in our gross revenue would be material at any time.

Q. I am talking about movements of grain.

A. I appreciate that, but the same applies; it is a matter of degree.

Q. Just one question on the joint exhibit, Mr. McCoy, related to the memo which you prepared; it is paragraph 31 on page 11 of the joint submission, exhibit 45.

A. All right, I have it.

Q. It starts off: "National policy as

[illegible]

reflected in the statutory grain rates has imposed upon the railways obligations and limitations..." and so on.

Now, it is the word, "imposed" that I am questioning in the light of what you have quoted in your memo, which is an extract in the 15 per cent case, where the statement is made at the bottom of page 7, quoting from the judgment,

"'The statutory grain rates, of course, are the result of a contract made in 1897 between the Canadian Pacific and the Government of Canada, for which that railway received certain considerations,...'"

and so on.

How do you reconcile that word "imposed" and the statement which appears from the judgment to the effect that these rates are the result of a contract?

A. Well, Parliament, as I understand, took them out of the contractual base and made them statutory, and the Canadian National was caught with rates at an 1899 level.

In other words, we had what you might say truthfully was an unrealistic rate level imposed on the Canadian National, because certainly I don't know of any rate man today who would ever - I mean, railway rate man, who would ever dare to make a freight rate related to a Crow's Nest grain rate and expect to come out even.

Q. This statement has reference more

particularly to Canadian National?

A. It is a joint submission but I think that the application is perhaps a little bit more so on the Canadian Pacific because they have a greater tonnage of grain than Canadian National.

Q. You do recognize this statement from which you have quoted in the memorandum that the rate is as the result of this contract; that is a fact?

A. They flow from the contract.

MR. DICKSON: All right.

THE CHAIRMAN: Mr. Wood?

MR. WOOD: Sir, first of all I would like to say that my voice is bad because I have developed a bit of a virus, but I would like some clarification on one point that arose this morning with respect to the comments on the movement of grain from Edmonton to Fort William. My information is that the terminal there, which was referred to as being owned by the Alberta Pool is, in fact, leased to and operated by Manitoba and that the movement of grain - at least, the grain to that terminal is very negligible, indeed. This is simply to clarify, apparently, some misunderstanding.

THE CHAIRMAN: Alberta purchased that terminal as an investment.

MR. SINCLAIR: I wonder if we could be told whether it is a profitable investment, particularly in the last two or three years. I put that formally as a request for information.

[illegible]

[illegible]

[illegible]

MR. WOOD: Well, I refuse to give it.

MR. SINCLAIR: On what grounds?

MR. WOOD: I don't think it is relevant.

MR. SINCLAIR: I think it is relevant to show that the Alberta Wheat Pool is a grain handling organization for profitable investments,and I think that maybe the Commission should be vitally concerned about that.

THE CHAIRMAN: I think we have enough territory to cover without going into that.

MR. SINCLAIR: It is in connection with a submission which I might want to make at a later stage, and I think the information I have requested is necessary for it, and I would ask the Commission to direct Mr. Wood on behalf of his clients to produce that information. That would be my submission, and I so ask the Commission.

THE CHAIRMAN: Undoubtedly, Mr. Sinclair, you will have a witness from the Alberta Pool before we get through with this business, and he would be the proper person to ask and to answer that question.

MR. SINCLAIR: Mr. Chairman, with your permission, it would be my submission that it would assist me in my cross-examination of that witness if I had this information in advance so that I could properly understand it and put the questions for the assistance of the Commission.

THE CHAIRMAN: All it is is to assist you in cross-examination?

MR. WOOD: Is Mr. Sinclair prepared to pay for the cost of developing it?

MR. SINCLAIR: The answer to that question is yes. On that basis we will be supplied with it?

MR. WOOD: I doubt it.

MR. SINCLAIR: My answer to that is yes, and I am glad that my friend put it.

THE CHAIRMAN: We will consider your request.

CROSS-EXAMINATION BY MR. WOOD:

Q. Can you advise me as to the minimum loading applicable to class 8 freight in 1925?

A. I haven't got the classification for class 8, but it is my recollection that it is about the same as it is today. I don't know whether it has been changed or not, but I don't think so. I think it is around 30 or 36 thousand lbs. per car.

Q. That leads into the second question; I wondered if you could give me information as to the loading applicable to class 33 in 1958?

A. Class 33? That would be rather difficult; I don't know whether I could get it or not, but you will have to give the various commodities. That is usually a grain classification or rating, and you would have to also say if you want it in commodity rated traffic, class rate traffic, an average of both, or do you want it broken down individually?

Q. I want an average.

A. Average only?

[illegible]

Q. Yes.

A. On the commodity rated class in column 30. I don't know whether I could get that or not, but I will make a run at it.

Q. Perhaps I can find that out later.

MR. MACDOUGALL: Is the grain the item which you are particularly interested in?

THE WITNESS: I am just informed that the classification is 40 thousand at the present time; what it was in 1925 I can't say at the moment.

MR. WOOD Q: My information on that is that it is 30 thousand.

A. Well, at least we have made some progress in our classification.

Q. Yes. Now, one last question, Mr. McCoy; to your knowledge did any grain or grain products whatsoever in 1958 move on class 30 rates?

A. I couldn't give you a specific answer to that question without going through all of our waybills, which would be hundreds of thousands.

Q. I simply ask it to your knowledge.

A. Not to my knowledge, I don't know.

MR. WOOD: That is all, thank you.

MR. FRAWLEY: He wouldn't mind doing that if he paid for it.

THE CHAIRMAN: Mr. Frawley?

MR. SINCLAIR: Before Mr. Frawley starts to cross-examine Mr. McCoy, I indicated a few days ago to one of my friends that there would be certain

information we would like from Alberta, and as time is going on I think maybe I had better formally put this on the record if this is a convenient time.

MR. FRAWLEY: This will take a half an hour.

MR. SINCLAIR: So that we will not have to give them to him all at once, but let him get at his job, I was wondering if he could find out from his clients in Alberta what was the effect of prices on commodities arising from reductions flowing from the one and one-third group; that is number one.

What was the effect of prices on goods in Alberta resulting from the reductions flowing from the applications of the bridge subsidy?

Thirdly, what was the reduction in prices of goods in Alberta flowing from the roll back that was instituted under the Act passed last year? That is merely a notice to my friend; I thought I should put it on the record, but I don't think he needs to answer it now.

MR. FRAWLEY: Don't be too technical.

THE CHAIRMAN: What do you want to cover?

MR. SINCLAIR: Such representative ones as my friend may wish.

MR. FRAWLEY: Leave it to me.

MR. SINCLAIR: I wish that my friend would consider this as his notice.

MR. FRAWLEY: Yes.

MR. SINCLAIR: And if he can't supply it, then what can he supply in substitution for it, and

[illegible]

MR. [illegible]

[illegible]

MR. [illegible]

[illegible]

MR. [illegible]

MR. [illegible]

[illegible]

MR. [illegible]

MR. [illegible]

[illegible]

MR. [illegible]

MR. [illegible]

[illegible]

the purpose of it is to enable the Canadian Pacific to deal with the question of whether freight rates are and what effect they have upon the prices of goods in Alberta.

THE CHAIRMAN: And he is paying for all this.

MR. SINCLAIR: I would be glad to discuss the supplying of that information, and I think I would be able to arrive at a mutually satisfactory disposition of that question.

MR. FRAWLEY: It will be pretty hard.

CROSS-EXAMINATION BY MR. FRAWLEY:

Q. Mr. McCoy, I gave you this morning a document, CNR Statement A, which is really a reproduction, virtually, of your exhibit 58-14 in the 17 per cent case.

A. Yes.

MR. FRAWLEY: I would like to offer that as an exhibit. I gave the secretary some copies of it this morning and the number will be ---?

MR. COOPER: Exhibit 80.

EXHIBIT NO. 80: Canadian National Railways estimated result of general freight increase of 19 per cent (25 cents per ton on coal and coke) for the 14 month period, November 1, 1958 to December 31, 1959, before the Board of Transport Commissioners.

MR. FRAWLEY Q: Now, Mr. McCoy, would you mind looking at the statement for a moment. You told my friend Mr. Dickson that you were busily

engaged in increasing the number of agreed charges.

A. Well, I didn't say I was personally busily engaged; I said the railways were constantly reviewing those. They are under constant review.

Q. So, the railways are busily engaged in increasing the number of agreed charges?

A. We endeavour to not let them go too long.

Q. Well then, looking again at that exhibit, that is, you would increase the number of agreed charges, and then that item Number 6, "All other freight traffic" would shrink, wouldn't it?

A. That might shrink; it would all depend upon the conditions prevailing at the time. For example, you might have a large upswing in railway transportation and the dollar might remain the same, but the percentage would change.

Q. You would expect that item 5 "agreed charges" to increase, and then item 6 "all other freight traffic" would shrink?

A. That might be, yes sir.

Q. And that is the item, item 6 "all other freight traffic" which was 35 per cent of the revenue for that test period; that is the item which took 73 per cent of the last freight rate increase?

A. That was the estimate at the time, yes sir, and had the grain rates gone in the percentage would have been higher.

Q. I wouldn't want you to fail to mention

[illegible]

that. However, the fact is that 73 per cent of that freight rate increase that you applied for, in the case of Canadian National, was coming from the 35 per cent of the traffic revenue, and this was an estimated traffic period of November 1st, 1958 to December 31, 1959, but at that time you were estimating the agreed charge leading up to the 31st of December, 1959.

A. That is right, sir.

Q. The agreed charges have been coming along pretty briskly, haven't they?

A. That would be one way of sayig it, yes; they certainly have increased, there is no question about that.

(Page 3197 follows)

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q. Now, I obtained through the courtesy of the Board's Traffic Department these figures, and I would like to put them on the record ---

A. Just a moment, sir; I would like to check them as you go along.

Q. I am told that as of today -- you could not do any better than that -- there were filed 880 agreed charges?

A. Well, as at December 31st, 1959, my check is 876. Eight hundred and seventy-six agreed charges were issued; 760 were in effect as of December 31st last year.

Q. Now, I will give you today's figures. They gibe very well with that. Total filed 880, less charges chancelled, 117, leaving 763, of which 757 are in effect and the remaining six are filed, but they are in the waiting period waiting to become effective. Now, with that situation, I might look at your Exhibit 78, or the railways' Exhibit 78, which was filed a day or so ago, and I want ----

A. That is the Canadian Pacific.

Q. Is it a Canadian Pacific exhibit?

A. Yes.

Q. Let me ask, then: are these agreed charges only the agreed charges in which Canadian Pacific are interested?

A. No, the Canadian National are interested in them.

Q. Well, then, I can discuss them just as satisfactorily with you.

A. Some are Canadian Pacific and some, I believe, Canadian National.

Q. Let me go back to Exhibit 80 for a moment. You told me that, in view of the increase in Agreed Charges and in competitive rates, your competitive rates are also increasing all the time?

A. That is correct.

Q. And every time you file a new competitive rate it displaces a class rate or a non-competitive commodity rate?

A. That is correct, yes, sir. But they do not become static.

Q. No; I am just taking it step by step now. So looking at Exhibit 80, Items 4 and 5, and as Items 4 and 5 increase then Item 6 undergoes a shrinking process?

A. It may work out that way; I wouldn't give a firm answer Yes. You would have to have your traffic pattern.

Q. If you were privileged to go before the Board today with a rate case -- and there is one pending, an application for 12 per cent -- I am wondering -- perhaps it is too speculative for you to help me or the Commission -- would you venture to say what percentage of the total increase that you would be seeking would be taken from Item 6?

MR. MACDOUGALL: I don't think that is a fair question to put to Mr. McCoy. It is a hypothetical question. He asks if the case was before the Board what Mr. McCoy would say in answer.

MR. FRAWLEY: I think it is somewhat

speculative, and we will pass on.

Q. Would you look at Exhibit 78? When I first saw that it looked to me like a ten-page exhibit, but if you will look at it you will see that it has been broken down very conveniently into six or seven parts, and I would like to go through that with you now. If you look at the first page, you will see the heading: "Agreed Charges which were increased by negotiation as a result of the 21% General Increase, effective April 8th, 1948, authorized by the Board of Transport Commissioners for Canada, Order No. 70425, dated March 30, 1948." In other words, it appears that the company which prepared this exhibit has gone back to 1948 ---

MR. SINCLAIR: That is what Mr. Frawley asked us to do. That is why we did it.

THE WITNESS: Of course, Mr. Frawley, I did not prepare this exhibit.

MR. FRAWLEY: Q. You are very seldom at a disadvantage looking at an exhibit that has to do with freight rates. Just look at that and see if that isn't what the first page does?

A. That certainly is the way it reads.

Q. I have marked that simply for convenience as "A".

Now we go to what I call Statement "B", and they are the agreed charges which were increased by negotiation as a result of the 20% increase in 1950?

A. Yes, that is the reading of the heading.

Q. And then I go to the statement which I

[illegible]

call for convenience "C", and they are the agreed charges which were increased by negotiation as a result of the general increases there set out, 17% in 1952, 9% in 1953 and 7% in 1953. That appears to be the situation?

A. Yes, sir, that is the heading.

Q. And then we go to the section which I have conveniently called "D", which consists of two pages, and that very clearly sets out that these are the agreed charges which were increased by negotiation as a result of the 11% general increase effective January 1st, 1957?

A. Yes.

Q. And then we go to the three-page section which I have, just for simple convenience, called "E", and these are the agreed charges which were increased by negotiation as a result of the 17% increase of December 1st, 1958?

A. Yes, sir, that is the heading on page 1 of three pages.

Q. And then we go to the next section, which I have called "F", which are the agreed charges containing the Standard Escalator Clause which has been increased to reflect general increases authorized by the Board of Transport Commissioners for Canada, and that is a one-page exhibit which I have called "F".

There is a final page which I have called "G", agreed charges containing the modified escalator clause which have been increased due to the 17% general increase authorized by the Board of Transport Commissioners

[illegible]

for Canada, and the reference is Order No. 96300, 17th November, 1958?

A. That is right.

Q. If you will run through the exhibit with me now we find that what I call "A" has nine agreed charges which suffered an increase.

A. I would not say the word "suffered" is the word to use.

Q. Maybe they enjoyed it?

A. That is better.

Q. Then we go to Statement "B", and we find that eight agreed charges took an increase?

A. Yes.

Q. And then we go to "C" and we find five agreed charges took an increase?

A. Yes.

Q. Then we go to Statement "D" and we find thirty-two agreed charges took an increase?

A. I am accepting your figures; I am not adding these, sir.

Q. And then "E", the three-page statement, and there would appear to be thirty-six agreed charges took an increase, and the kind of increase they took appears in the remarks column on the right-hand side, and some of them run from big, little and small; I see 50 cents, 60 cents, 55 cents and 63 cents, and so on. There is one here on lumber which went from 26 cents to 27 cents.

A. You mean the one on page 2? Twenty-six cents to 27 cents, that is correct.

Q. Then "E", thirty-six, and then we go to "F" and we find that twelve agreed charges took an increase; and then statement "G", we find that nine agreed charges took an increase. I haven't added them all up, but when you keep in mind that we now have 757 agreed charges in effect, I suggest to you that there is nothing very monumental about the success of the railways in putting these up?

A. I can't agree with you, because, having gone through a great many of the negotiations, I can assure you that we have not given the entire picture by just showing the number of increases we have been successful in getting. Had we had an exhibit prepared which would have shown the ones that we tried to get an increase on in which we were not successful, it might give a different picture entirely. I want to assure the Commission that we are not negligent; we are anxious to get the proper rates on a realistic and competitive basis.

Q. I am not suggesting that the railways are not trying their utmost to get every cent out of the agreed charges; all I am suggesting is that the economic facts that the railways are faced with don't permit them to put the agreed charges up any more than they are.

A. In certain circumstances, that is correct.

Q. I would like to take you to page 13 of your precis and ask you something about that.

MR. MACDOUGALL: I might just mention, Mr.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Chairman, that I have explained to Mr. Frawley that Exhibit 78 on the Agreed Charges includes, I am instructed, the local C.P.R. agreed charges from local points to other local points, but it does not include the local Canadian National Agreed Charges between our own local points.

THE WITNESS: I have to differ with you. There is one here from Cardinal, Ontario, Canada Starch.

MR. FRAWLEY: Q. You don't think that has been taken away from you?

A. Not to my knowledge -- 153, D2. It might be joint. British Columbia, to Vancouver, it would be local. We would haul it ourselves. But my point is that on this exhibit there are agreed charges applicable from a local Canadian National point. That is my contention.

MR. MACDOUGALL: Are there any more, Mr.McCoy, except that one?

THE WITNESS: That is the only one I find in hastily going through it. I apologize in having to differ with counsel.

MR. FRAWLEY: I am quite sure a statement could be made to supplement it to show local agreed charges, but I will not press for that.

Q. Now, Mr. McCoy, would you look at page 13 of your precis in which you say that the reimbursement that you wish from the Federal Treasury is an amount to reach a just and reasonable level of return?

A. That is the end of the first paragraph on page 13?

Q. That is right.

A. Yes, sir.

Q. To read it clearly into the record, I am just reading from the fourth last line:

". . . and the railways be reimbursed for the cost of the work performed in handling this traffic by means of a payment made to them equal to the difference between the statutory rate and the amount found to be a just and reasonable level of return."

Now, we can go a little further, can't we, Mr. McCoy, and I can put it to you that the just and reasonable level of return you seek for the export grain rate is the full cost?

A. I don't know whether you could put it that way exactly. The amount found to be a just and reasonable level of return is one thing, but if you are going to operate your entire plant to just get your total cost, you would be in trouble. But in this instance the movement is basic to the plant, as Mr. Edsforth has testified, and while I want to qualify, we have not suggested anything, we have told our story, and this is what we need.

Q. For instance, take page 3 of the statement Exhibit 46. I think we find it in several places, but look at page 3 and paragraph 7.

A. I just want to make it clear; that is all I am after.

Q. That is right, and I think there isn't any question about it at all. In paragraph 7 -- there

[illegible]

would have to be a few corrections -- the paragraph says:

"The cost study shows that the present gross revenue from this traffic fails to meet even the variable cost of handling it. The gross revenues from this grain traffic should cover not only the variable cost but also a reasonable portion of the constant cost. With total costs shown to be $58.8 million during 1958 and comparable revenues of $28.6 million, an increase of 123 per cent over the present revenue level would enable Canadian National to cover its total costs."

That, I understand, is precisely what the Canadian National and the Canadian Pacific is asking.

If you turn to page 4, paragraph 10, you say there:

"The application of conventional rate-making principles shows that an increase of 125 per cent could be made in the existing rates without disturbing the 1927 commodity to class rate relationship."

So I am quite right in putting it to you that what the railways think will turn this export grain rate into a just and reasonable rate and put it on a just and reasonable level is a rate which will give them a reasonable cost?

A. On grain only; we are only talking about grain, I hope.

Q. That is right. There is now a rate of 20 cents. Isn't the Edmonton and Calgary rate 20 cents?

A. That is my recollection. The rate to Vancouver you are discussing?

Q. That is correct; and, notwithstanding that the Alberta Wheat Pool has bought an elevator and rented it out at the lakehead?

A. I qualified that in my statement, I think, yesterday or today. In fact, I have got the ownership statement from the Alberta Wheat Pool, Alberta issue.

Q. You read that issue?

A. I find it very illuminating. Manitoba Pool No. 9 is owned by the Alberta Wheat Pool, but is operated by the Manitoba Pool.

MR. FRAWLEY: I have just checked the rate from Calgary and Edmonton to Vancouver. It is 20 cents.

(Page 3210 follows)

Q. What I am interested in is what you would make that rate. Would you make that rate 125 -- would you put 125 per cent increase on that rate?

A. That would be a 45 cent rate, as I would calculate it.

Q. Yes. Well that's right. You would double it plus. It would now become 45 cents?

A. Yes, sir, and that would be 45 -- 81 cents, your corresponding Seattle rate from Shelby, Montana.

Q. Put that in right there.

A. That would be 56 cents less.

Q. Put something else right down beside it. What is the domestic rate from Edmonton to Vancouver?

A. I haven't the figure there.

Q. I am sure Mr. Frawley has it.

A. He has the grain rate, but he has not got it here.

Q. This is just an export grain inquiry. He hasn't got the import grain rate. I think it is somewhere up around -- now, it has reached about 60 cents plus?

A. I would say it would be in the vicinity, probably, of 62 cents. But I gave my memory a terrific test on that one.

Q. You are asking the export grain to carry the full cost and this 45 cents, but you haven't any compunction in asking domestic grain to

carry the full cost plus half as much again?

A. That is ordinary business practice, sir.

Q. Yes, of course it is.

Now, I want to talk to you about some other rates. And I think for your convenience I will give you a copy of two rate compilations that have been made for me and I'm afraid,Mr. McCoy,that there is nobody else but you and I are going to be able to participate in this.

MR. SINCLAIR: Mr. Chairman, I notice that it is just before 4:00 o'clock and I presume he is going on to another subject.

THE CHAIRMAN: Well, I thought the same thing.

MR. SINCLAIR: And I want to say this, sir, and that is why I rise,with your permission, and Mr. Frawley's permission, so that also Mr. MacDougall would have the opportunity of looking at this little tete a tete they are going to have.

I would want to make it clear that the request I made is for the development of information as to the effect on prices in the province of Alberta resulting from specific rate changes.

I would also like to say that I am not picking out Alberta.

MR. FRAWLEY: I thought that was just some more discrimination against Alberta.

MR. SINCLAIR: With your permission, Mr. Frawley, I would like that information also as

it applies to the bridge subsidy and the roll-back from the Province of Manitoba and from the Province of Saskatchewan, and, as I say, we would likely have other requests for these provinces to assist us in assisting the Commission, as we see it. But I did not want my friend to think that there was any joke about this at all. We do need this information as we see it to make a proper presentation to the Commission. We have no way of ascertaining it. The information must be wholly in the hands of the people they represent, seeing that they represent, as some of them have said, all of the people of Alberta, or all the people of this place or that. So, therefore, I do think, Mr. Chairman, I would like it to be known that we were not picking out Alberta; that we want that extended also to Saskatchewan and Manitoba, insofar as the three points, the rate changes, were applicable in those provinces.

MR. FRAWLEY: I will have to look at the transcript in the morning to see what my friend is referring to. If this information is available in any of the departments of the government of Alberta, I am quite certain it will be forthcoming very quickly. If it is not in any of the departments of the government of Alberta, I haven't an idea of what my friend expects me to do.

MR. SINCLAIR: May I take it that my friend on behalf of the government of Alberta is refusing the request if it is not readily available?

MR. FRAWLEY: I do not know what he is expecting.

THE CHAIRMAN: We are giving the matter considerable consideration.

Now, Mr. Blair, I see you are here, and our friend, Mr. Brazier, I understand was under the weather out in British Columbia.

MR. BLAIR: Yes, he is. Mr. Brazier was in touch with me yesterday. He finds he is not well enough to come down, certainly for the early part of this week, and it may be that he will not be able to come down before the Commission rises.

There are a few questions which the Province of British Columbia would like to put.

THE CHAIRMAN: I understand, Mr. Blair, that you are busy in another place, and that you may be there tomorrow morning. If it was agreeable to you if you come here at 2:00 o'clock tomorrow afternoon when Mr. McCoy will be here, you may cross-examine him at that time.

MR.BLAIR: I very much appreciate the consideration, Mr. Chairman.

THE CHAIRMAN: We will adjourn now until 10:00 o'clock tomorrow morning.

---Whereupon the hearing adjourned at 4:00 p.m. to resume at 10:00 a.m., Wednesday, January 20, 1960.